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IMPACT OF INFLATION ON SMALL BUSINESS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON GENERAL OVERSIGHT AND MINORITY ENTERPRISE

OF THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

NINETY-SIXTH CONGRESS

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CONTENTS

Hearings held on—

Page
April 16, 1980 1
April 17, 1980 131
May 13, 1980 247

Opening statements of—

Addabbo, Hon. Joseph P., a Representative in Congress from the State of New York 4
Bereuter, Hon. Douglas K., a Representative in Congress from the State of Nebraska 4
LaFalce, Hon. John J., chairman, Subcommittee on General Oversight and Minority Enterprise 1, 131, 247

Testimony of—

Dellomo, Anthony E., vice president, Citibank 78
Henson, Daniel P., III, director, Minority Business Development Agency; accompanied by Abdul Shaikh, deputy associate director for policy; and Barry Robinson, chief counsel 229
Hjort, Howard W., Director of Economics, Policy Analysis and Budget, U.S. Department of Agriculture 234
Martin, David L., president, Allied Window Manufacturing, Inc 57
Paul, Walter, president, Queen City Barrel Co., appearing on behalf of the National Small Business Association; accompanied by Jerome R. Gulan, legislative director, NSBA 71
Reardon, Paul, director, Inflation Fight Center, U.S. Chamber of Commerce 51
Roistacher, Elizabeth, Deputy Assistant Secretary for Economic Affairs, Department of Housing and Urban Development; accompanied by Kevin Villani, assistant to the Deputy Assistant Secretary 99
Schultz, Frederick H., member, Board of Governors, Federal Reserve System 132
Shelton, Robert, vice president and general manager, Anderson Tool & Engineering Co., Inc 54
Smith, Herman J., first vice president, National Association of Home Builders; accompanied by Robert D. Bannister, senior staff vice president for governmental affairs, and James Schuyler, legislative counsel 5
Stewart, Milton D., Chief Counsel for Advocacy, Small Business Administration; accompanied by Robert E. Berney, Chief Economist 248
Stewart, Milton, Chief Counsel, Office of Advocacy, Small Business Administration; accompanied by Paul L. Macler, president, Macler Industries, Inc., Friendship, N.Y.; Ron Piercy, president, A-D-E Lumber Supply Co., Inc., Kansas City, Mo.; Santos T. Abrilz, Jr., president, Apoca Industries, Inc., Deer Park, N.Y.; Robert Carr, president, Seacor, Cherry Hill, N.J.; Sam A. Pasch, president, Men's Wear Retailer Apparel Association of America, and president, Polacheck's, Milwaukee, Wis.; and Harold Stone, Aba Small Business Committee 81
Viscusi, Kip, Deputy Director, Council on Wage and Price Stability 111
Zayas, Edison, R., economist, National Federation of Independent Business; accompanied by Abe Schneier, tax consultant, research department 32

Additional material supplied for the hearing record—

Page

- Hjort, Howard W., Director of Economics, Policy Analysis and Budget, U.S. Department of Agriculture: Prepared statement 235
- Paul, Walter, president, Queen City Barrel Co.:
  - A policy recommendation of the small business community 75
  - Letter from the National Small Business Association to the President, dated March 28, 1980 76
- Roistacher, Elizabeth, Deputy Assistant Secretary for Economic Affairs, Department of Housing and Urban Development: Prepared statement 99
- Schultz, Frederick H., member, Board of Governors, Federal Reserve System:
  - Prepared statement 133
  - Reporting requirements 136
- Smith, Herman J., National Association of Home Builders:
  - Housing forecasts and economic assumptions 15
  - Possible tax losses due to failures of construction firms and loss of profits in 1980 utilizing 5-year carryback and 3-year carryforward provision of tax law 21
  - Prepared statement 5
  - Private rentals versus multifamily starts 20
- Stewart, Milton D., Chief Counsel for Advocacy, Small Business Administration:
  - Prepared statement and attachments 248
  - Tables 337
- Viscusi, Kip, Deputy Director, Council on Wage and Price Stability:
  - International inflation comparisons 125
  - Prepared statement 112
  - Prior testimony of Alfred E. Kahn 119
- Zayas, Edison R., economist, National Federation of Independent Business: Prepared statement 32

IMPACT OF INFLATION ON SMALL BUSINESS

WEDNESDAY, APRIL 16, 1980

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GENERAL OVERSIGHT
AND MINORITY ENTERPRISE OF THE
COMMITTEE ON SMALL BUSINESS,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:10 a.m., in room 2359-A, Rayburn House Office Building, Hon. John J. LaFalce (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN LaFALCE

Mr. LAFALCE. The subcommittee will come to order.

This morning, the subcommittee will commence a series of hearings investigating the impact of inflation and the administration's anti-inflation policies on small business.

Inflation is our Nation's No. 1 domestic problem and it affects large and small business alike. But the recent increase in interest rates and the administration's new anti-inflation policy have exacerbated these problems for small business.

Both the Congress and the administration have addressed themselves to the pressing problems of inflation and its debilitating impact on our economy. However, conspicuously lacking is a special strategy to cope with the unique problems of small business.

The development of a national strategy on small business and inflation should be a critical item on our national agenda; yet, it has not been. Let me give but one example of what represented itself as a comprehensive attack on inflation, but made almost no mention of small business' unique problems.

The Task Force on Inflation of the House Committee on the Budget undertook an assessment of the various causes of inflation and its impact on all segments of the economy in an attempt to initiate an inflation dialog which would serve as a launching point for ongoing consideration of the inflation problem.

Unfortunately, there was no direct mention of either the important role of small business in holding down inflation or the impact of inflation on small business.

For example, the task force recommended a sound jobs program, with perhaps a Government guarantee of jobs when the private sector cannot provide them. However, no mention is made of the fact that small business is the single biggest creator of new jobs in our economy.

Another recommendation is that we promote competition as a way to force prices down. Unfortunately, competition is lacking in many sectors of the economy. Too many conglomerates are spending their money not on new ideas or research and development but rather on finding new subsidiaries.

While noting that incentives for small business development should be encouraged, none were set forth.

Regarding productivity, the task force noted that if productivity goes up 1 percent, the inflation rate will come down at least 1 percent. Michael Evans, president of Evans Econometrics, goes even further by estimating that a 1-percent decline in productivity will produce a 2-percent increase in inflation. Yet no mention is made in the report of assisting small business. As I have said repeatedly during numerous subcommittee hearings on productivity, the small business community is directly responsible for most of the research and development which leads to greater productivity. Despite the importance of declining productivity, neither this nor past administrations have demonstrated any realization of the need to promulgate a national plan for productivity.

The report also summarized the impact of inflation on consumers, the elderly, youth, minorities, and rural and urban populations. Again, no examination was conducted on the impact on small business, although the task force did recognize that "small businesses have historically been hotbeds of entrepreneurship and innovation in the United States." For example, half of the major innovations in the American economy have come from firms of fewer than 1,000 employees and a quarter from firms with less than 100.

The White House in its "message on small business" delivered to the delegates at the White House Conference on Small Business emphasized the "vital importance of the small business sector to the American economy." Regarding inflation, the President stated:

> Our efforts to control inflation, maintain high levels of employment and stimulate productivity and economic growth depend in large measure upon a strong small business sector. Yet, too often in the past the Federal Government has been insensitive to the needs and concerns of small business.

The President attributed Government insensitivity to the "popular misconception" that small business is not a significant factor in our economy, although they account for more than 50 percent of all private employment, 43 percent of the gross national product, and over half of all inventions.

One of the conditions inhibiting the formation and growth of small business, according to the President, is inflation, which often places special strains on smaller businesses; they are less able to pass along cost increases, and they face special financing problems due to high interest rates and tight credit. He urged the Nation and the banks to take particular care that small business, home buyers, and farmers receive a reasonable share of available funds.

Last October, I made a similar request to both Chairman Volcker of the Federal Reserve Board and all chief executive officers of banks in western New York, which I happen to represent.

However, as part of the President's anti-inflation policies announced on March 14, 1980, there was no specific strategy to help small business cope with the problems of inflation. The only mention of small business was in the context that small business, as well as other sectors of the economy, might need some accommodation of credit.

The implementation of standards designed to provide for some credit accommodation to borrowers such as small businesses was specifically left to the discretion of lenders. While theoretically the Federal Reserve Board might review the banks' policies as they affect small business, we must defer to a later time to see whether or not there is actually any accommodation.

Double-digit inflation has many complex causes, which all must be dealt with in a coordinated fashion. Without a comprehensive strategy against inflation, success will elude us. Monetary restraint, strict budgetary discipline, effective energy conservation, and improved productivity are all necessary.

However, part and parcel to not only understanding inflation but also to combating inflation is a recognition of the role of the small business community.

Small businesses not only add to innovation, but to jobs creation, sales growth, and Federal revenues. These are all basic ingredients to resolving the inflation equation. A 5-year MIT study found that 6 mature companies with combined sales of $36 billion in 1974 experienced a net gain of 25,000 jobs, while 5 young companies with combined sales of $857 million had a net increase in employment of 35,000 jobs.

Small business has been dealt a crushing blow by inflation. Inflation impacts small business in at least three ways: First, inflation itself; second, the problem caused by the tight money policy used to control inflation; and, third, the exacerbation of problems already confronting small business because of inflation.

There is a pervasive misconception of the role of small business, I think. We need to reexamine the competitive structure of the U.S. economy and the increasing trend toward economic concentration. In so doing, the Congress can learn how to deal with the conditions which inhibit the formation and growth of small business. Failure to take appropriate action to safeguard the small business community will result in irreparable damage to our economy and society.

Without a national strategy for small business to cope with inflation, we will be sending 14 million small businesses nothing but desperate hope. Unfortunately, hope alone does not serve as acceptable collateral for a bank loan, even if one is available at a reasonable interest rate; hope alone does not communicate to small business our recognition of their vital role in the economy; hope by itself is a meaningless incentive for those men and women with dreams and visions of starting a small business, but now fear the attendant risks; and hope, with nothing more, will eventually turn to cynicism and serve to shatter the dreams and visions of those who once took the risk of starting a small business only to see it fail because of ravaging inflation.

The witnesses appearing before us today and tomorrow represent small business trade associations, Government agencies, and the financial community. We hope that through their testimony we can determine the scope of the problem, and what, if any, special efforts are being made by Federal agencies to help small businesses cope with an unprecedented high inflation rate; and, further, if such special efforts are lacking, what efforts may be necessary.

Failure to deal with the special problems of small business in a timely manner could result in the stifling of the future for small business as an important and integral part of our Nation's economy.

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At this time we have with us Representative Joseph Addabbo. I wonder if he has any comments he would like to make?

OPENING STATEMENT OF HON. JOSEPH P. ADDABBO, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. Addabbo. Thank you, Mr. Chairman.

It is indeed a pleasure to be here. I commend you on bringing to the forefront this most important question of inflation. I think inflation is the most important matter facing the Nation, as you so aptly point out.

Again, I commend the small man who will be most hurt.

I regret that I will not be able to stay with you for the entire hearings. I will carefully study the testimony and the questions and answers because of the importance.

I do have to go back to the committee that I chair, which is considering defense dollars so that we can help our small business here.

I think the American people must understand that this question of inflation is actually as important as if we were at war with an enemy. This inflation, unless we all work together to fight it—and I think productivity is one of the greatest weapons we have—and unless we act as if we are in a war, it can easily destroy our economy.

Again, I commend you, Mr. Chairman, for considering this most important subject.

Mr. LaFalce. Mr. Bereuter?

OPENING STATEMENT OF HON. DOUGLAS K. BEREUTER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEBRASKA

Mr. Bereuter. Thank you, Mr. Chairman.

I would like to commend you and the staff for putting together an excellent and interesting list of witnesses. I look forward to the testimony.

I think there is the usual amount of cynicism about the product coming out of another White House conference. The White House Conference on Small Business was, unfortunately, held at a period of time when Congress was not in session. I think very few Members were able to attend.

I was able to attend. I found them quite serious about their efforts. I met with the entire delegation from my home State. They were committed to making that an ongoing process. We have met several times since.

A good part of our discussions at this point have been concerned with the immediate problems of inflation. I will be interested in what the perceptions and analyses are and whether that is borne out by the witnesses we have today.

Mr. LaFalce. Because of a request due to time constraints, I am going to be calling first the National Association of Home Buildings and their vice president, Mr. Herman Smith.

Mr. Smith, I noticed that you have a 15-page statement. Without objection, I now introduce the entire text of your testimony into the record.

You may summarize it as you see fit.

You may proceed.

TESTIMONY OF HERMAN J. SMITH, FIRST VICE PRESIDENT, NATIONAL ASSOCIATION OF HOME BUILDERS; ACCOMPANIED BY ROBERT D. BANNISTER, SENIOR STAFF VICE PRESIDENT FOR GOVERNMENTAL AFFAIRS, AND JAMES SCHUYLER, LEGISLATIVE COUNSEL

Mr. SMITH. Thank you, Mr. Chairman.

Mr. Chairman, with your permission we will present the committee with my written testimony and I will summarize as we go through it.

Mr. LAFALCE. Without objection, so ordered.

[Mr. Smith's prepared statement follows:]

PREPARED STATEMENT OF HERMAN J. SMITH, NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. Chairman and Members of the Committee: My name is Herman J. Smith and I am a home builder from Fort Worth, Texas. I am testifying today on behalf of the more than 121,000 members of the National Association of Home Builders (NAHB), who employ over 3 million workers. NAHB is the trade association of the home building industry, of which I am First Vice President. Accompanying me today are Robert D. Bannister, Senior Staff Vice President for Governmental Affairs and James Schuyler, Legislative Counsel. We are deeply appreciative to the Chairman for calling these most timely hearings on the devastating impact of inflation on small businesses, particularly on the housing industry.

Mr. Chairman, as you are aware, our industry is made up of predominantly small businessmen and women. Forty percent of our builders construct less than 10 houses a year; only nine-tenth of one percent build over 500 houses a year. Over 75 percent of our members build less than 25 units a year, and over one-half of our builders employ fewer than 5 persons. Although new residential construction accounted for about 4.7 percent of the Gross National Product in 1979—representing $108 billion—we are not a "big business" despite the powerful ripple effect of housing throughout the economy. You have correctly identified us as a highly competitive and fragmented industry—one of the most important "small business" industries in America.

I am afraid that my message today is very simple and deeply disturbing—the homebuilding industry is in serious trouble and is on the verge of collapse. And as in other housing declines in the past, millions of jobs of other small businessmen and their employees are in jeopardy in industries dependent on housing production. And equally as important, potential homebuyers throughout the country—particularly young families—are being priced out of the homeownership market and will be unable to achieve the dream of owning their own homes.

SHORT-TERM OUTLOOK FOR HOUSING

Let me give you an update on the condition of the housing industry as reported in published data.

Later today, housing starts figures for March will be released by the Department of Commerce. We expect them to continue the decline which has been registered over the last few months.

February new housing sales figures which were released last week show a decline of 10 percent below the rate of January 1980 and 26 percent below the February 1979 rate.

According to the Commerce Department, February starts dropped to 1.334 million, a decline of 9.2 percent from last February and 6.3 percent from January 1980. Single family starts were down 22.4 percent from February 1979 to a level of 774,000 in February 1980. Regionally, the Northeast was down by over 61 percent from February 1979 to February 1980 and the South declined by over 22 percent.

But February start figures do not reflect the seriousness of the current housing situation.

The impact of the mid-February Federal Reserve Board credit tightening is not taken into account.

Seasonal adjustments favor both January and February (the last three winters were cold and the winter of 1980 was relatively mild).

The rapid increases in interest rates which began at the end of February—over 19 percent prime rate and mortgage rates of over 17 percent—are not reflected.

February rate of building permits declined to 1.163 million, down 8 percent from January.

At interest rates of 16 to 17 percent, fewer than 5 percent of American families can qualify for an average $60,000 mortgage (See Exhibit "A").

There is one statistic which is particularly significant—the size of the housing inventory. According to Census Bureau figures released last week, there are 119,000 completed but unsold homes standing vacant throughout the country. This inventory has steadily increased since last July, even though the pace of new construction has been declining rapidly. This inventory translates into over $9 billion worth of unoccupied housing at today's average purchase price. The total housing inventory, including those units under construction or in the pipeline, totals almost 400,000. This inventory is as high as the inventory during the 1974–75 recession.

As this Committee is well aware, some 2000 members of NAHB—as well as lenders, suppliers, employees, subcontractors, and others—walked the halls of Congress just three weeks ago to dramatize the plight of this industry—and the frustration of potential homebuyers and renters. From these people, who are intimately familiar with local conditions, we received a story which differs substantially from the February published data. Frankly, the data has yet to catch up with the reality. This is what we—and many Members of this Committee—heard:

Sales of new homes have plummeted, with some areas of the country down by 80 percent to 90 percent.

New construction has virtually come to a halt in many parts of the country.

Construction workers and others in real estate lines of employment are losing their jobs. This means layoffs of lumber millworkers, cabinetmakers, appliance manufacturers and the like.

Builders have laid off many of their own employees.

Builders and subcontractors are going bankrupt, are about to go bankrupt, or are getting out of business.

The entire residential construction industry is on the verge of being shut down.

Mr. Chairman, the phenomenon which has occurred is somewhat unusual, even in the history of our "roller coaster" business. In most parts of the country today, virtually every ingredient necessary to achieve a reasonable—even high—level of housing production exists—available land, a reasonable supply of materials, a willing and able labor force, a record-high number of potential buyers, and I can assure you—a large number of builders capable of producing decent housing. All that is missing is affordable financing.

At 16 percent interest—today's prevailing rate—the payment on a 30-year $60,000 mortgage loan is $807 a month for principal and interest. At 12 percent interest—the going rate six months ago—the payment was $617 a month. At 10 percent interest—the going mortgage rate a year and a half ago—the payment on a $60,000 loan was $527.

It seems clear that the home building business, in effect, will be put out of business by our misguided and counterproductive anti-inflation policies.

NAHB HOUSING FORECAST

Based upon the NAHB Econometric Forecasting Service projections, which optimistically assume a decline in interest rates this summer, we predict a level of 1 million housing starts in 1980. (See Exhibit "B"). This is the lowest level of housing production since World War II. Even with the predicted gradual decline in interest rates, housing starts would drop to 875,000 seasonally adjusted annual rate in the fourth quarter of 1980. The single family starts forecast is even more frightening. New home starts would decline to the unprecedented rate of 500,000 in the fourth quarter of 1980. This represents less than one-third of the single family level in 1977 and 1978. (A state-by-state breakdown of the decline in housing starts and jobs lost is attached as Exhibit "C").

The loss of one million housing units in 1980—the difference between the NAHB forecast for 1980 and the 2 million starts recorded annually during 1977 and 1978—would result in a net loss of $125 billion in economic activity. More specifically, this level of activity would have a catastrophic impact on the national economy. It would result in:

the loss of 1.6 million jobs;
the loss of $27.5 billion in wages;
the loss of over $3.5 billion in federal tax revenues and $7.5 billion in combined federal, state, and local revenues.

This represents the equivalent of letting four Chrysler Corporations go bankrupt.

But much more is at stake here. Our inability to produce housing to meet the demands of the American people could well upset the social fabric of our country. Without a doubt, the result will be highly inflated housing costs when this industry recovers during the early 1980's. Thousands of skilled craftsmen will seek employment elsewhere and never return. Consequently, we will have to train a new work force when economic conditions improve. Building product manufacturers will delay indefinitely plans to expand their production capacities. Consequently, we will confront serious shortages of building materials when starts rebound during the next recovery. This will make the inflationary increases in housing prices during the mid 1970's, after the last housing decline, look like "child's play".

There are two other factors which I believe must be kept in mind when evaluating the current crisis.

First, the underlying demand for housing is very strong and will grow substantially through the decade of the 1980's. Projections indicate that during the 1980's, 41 million Americans will reach the prime homebuying age of 30. This compares with about 31 million who will have reached the age of 30 during the 1970's. The rate of new household formation will be 25 percent higher in the 1980's than during the last decade.

This increased rate of family formation is largely the result of the postwar baby boom and the number of increased single person households. We predict that there will be no significant drop in housing demand until the 1990's, when the "baby bust" generation of the 1960's enters the housing market.

When combined with the number of families currently occupying substandard housing and the number of housing units removed from the market each year by demolition, disaster or other means, an additional 23 million housing units would be needed during this decade (See Exhibit "D"). The demand for housing would not even be met by a level of production of 2 million units per year, which has traditionally been considered a "very good year" for housing. And any lower production levels will almost certainly result in increased upward pressure on home prices due to the simple facts of supply and demand.

RENTAL HOUSING

Second, the crisis in rental housing and the inability of the private sector to develop and operate multifamily housing in today's market will mean that rental housing will not be able to meet any substantial portion of the existing demand. In fact, as many potential new homebuyers are being priced out of the homeownership market, there has been a shrinkage in the available inventory of rental apartments nationwide. This gives young families increasingly limited choice in meeting their housing needs.

Let me briefly outline the problem. The numbers are quite startling. Statistics compiled by NAHB's Economics Department show that in the last three years, the annual net loss of rental housing has been about 1½ percent. Last year, the loss of rental units exceeded the number of new units constructed by about 20,000.

Equally as troubling is the low level of privately financed multifamily construction. In 1979, of about 430,000 multifamily rental units built, only about 210,000 were privately financed. Over 50 percent of the units were subsidized low and moderate income housing and FHA-insured multi-family housing. At the same time, losses to the inventory in 1978 due to demolition, fires and abandonment totalled about 250,000.

It is evident that high interest rates, increased operating costs and the expansion of rent controls have all but dried up the private market in rental housing construction.

This is occurring at a time when demand for multifamily housing is high. The nationwide multifamily rental vacancy rate fell below 5 percent in 1979, according to Census Bureau statistics—the lowest figure since this statistic was first compiled twenty years ago. After removing substandard units and second homes, the effective vacancy rate is about 2 to 3 percent. A vacancy rate over 5 percent is essential in order to provide for reasonable mobility in housing. In addition, there continues to be a substantial unmet need for housing for the elderly, large families, newly-forming households, and for replacement of older declining housing stock.

The recent General Accounting Office report on rental housing released on November 8, 1979, found that the shortage of affordable rental housing is so acute that immediate Congressional action is needed. GAO found that multifamily starts in the private sector last year were at their second lowest rate in 20 years. They projected that this year the private sector would provide only about 25 percent of the new rental units, and that most of these would be for high-income tenants. The 75 percent of the starts which are financed by government represent a troublesome trend and a tremendous increase over the 22 percent government share of starts in 1972 and 44 percent in 1978. In fact, while the government-aided share has increased over the past few years, the actual number of units produced has declined.

We are pleased that legislation is being developed by Members of both Houses of Congress to provide some form of tax incentive to promote private rental construction.

SHORT-TERM SOLUTIONS

What can be done in the next 90 to 120 days to head off this approaching housing depression?

Let me begin by saying that as long as interest rates remain at 16 to 17 percent levels, the housing industry will remain in serious trouble.

But the Congress and the Administration—working together and quickly—can provide some relief.

First, NAHB is calling for the immediate activation of a program like the "Brooke-Cranston" GNMA tandem program which provides below market interest rate mortgages for new homes and unoccupied homes in the housing inventory.

By activating this program now, the government can provide affordable mortgage financing for moderate income families who otherwise could not afford to purchase a home. In addition, I cannot overestimate the psychological impact of such a program to potential homebuyers and home builders throughout the country.

Let us look at the reality of the program. This is not a government "hand-out" which shows up on only one side of the ledger sheet as an expenditure. Rather, the government owns a marketable asset in the form of mortgages which are purchased and will be sold at a future date. This program is not a subsidy program that once spent is never recovered. Instead, this program represents an investment by the government in an industry which will be healthy during the 1980's.

As HUD officials have described Brooks-Cranston before the Senate Banking Committee, it is virtually a "no-cost" program to the government over the long term. Each new housing start produces about two new jobs which would not otherwise be available in the economy. Housing production and sales of existing inventory generated under the program produce jobs, increase federal personal and corporate income tax revenue, increase local and state income tax and property tax revenue . . . and save the government the enormous revenue loss which is the consequence of not activating the program. As even Federal Reserve Board Chairman Paul Volcker recognized in hearings before the Senate Banking Committee on February 25, "Maintaining a certain level of activity in (the housing) industry is not at all inconsistent with an attack on inflation over time. You don't want to close down the whole industry and then have to build it up again as soon as money becomes more available."

By itself, this program will not save our industry. But it will help. It will help the housing industry which has been singled out to bear a disproportionate share of the fight against inflation.

We builders seek no special favors from the government. We ask only for fair and equitable economic treatment for our industry which is being ripped apart by the economic policies now being imposed by the Federal Reserve Board.

Our industry differs from the Chrysler Corporation. We have a successful product, we have a strong, effective marketing program, and we have buyers ready and willing to buy our product. The only reason our industry is in distress is the effect of government action to reduce inflation in the overall economy. The government got us into this mess, the government will have to help us out of it.

TAX EXEMPT REVENUE BONDS

Our second major goal is to preserve the tax exempt revenue bond program for single family housing.

Until last April, states and local communities were selling these tax exempt bonds to raise low cost mortgage funds for middle and moderate income families.

Last April, Ways and Means Committee Chairman Al Ullman introduced legislation which virtually prevented state and local governments from using these bonds to provide financing for single family housing. We believe that the bill finally approved by the House last month will virtually prohibit the use of revenue bonds for single-family housing in the future because of its complex and unworkable set of restrictions.

It has been said that revenue bonds are a drain on the Federal treasury. But that argument fails to recognize that the tax exempt bonds would generate the sale and construction of homes that otherwise would not be built or sold in today's economic climate. And the sale and construction of new homes generates as much or more tax revenue as is lost because of the tax exempt feature of the bonds.

The U.S. Treasury estimates that each $1 billion in revenue bonds will result in an annual loss in Treasury revenues of between $22 million and $30 million per year. However, the Treasury Department has failed to recognize the revenue increases from the creation of jobs and personal and corporate income taxes generated because of increased construction activity.

NAHB has estimated that $1 billion in housing construction would produce:

37,000 man-years of work;
$62.5 million in federal personal income tax;
$8.5 million in state income tax;
$21.6 million in local real estate taxes;
$34.6 million in federal corporate income tax; and
$592.0 million in indirect wages.

The Treasury has also failed to include in its calculations the economic effects of the present housing crisis, including the cost of bankruptcies and business failures to builders and material suppliers and the cost of compensation to unemployed construction workers. With only a 3 percent builder bankruptcy rate, tax loss from business failures and loss of profits could cost the Federal Treasury $5.8 billion.

We are hopeful that the Senate will recommend a more reasonable approach to the revenue bond issue and that a House-Senate Conference will fashion a workable bill.

BUILDING ENERGY PERFORMANCE STANDARDS

Our third major goal is to delay the implementation of the Building Energy Performance Standards, known widely as BEPS.

The BEPS set energy efficiency goals that will ultimately govern all new buildings constructed in the United States.

BEPS set design energy budgets for 19 building classifications in 78 climate types. Each new building, including new homes and apartments, must be designed to use no more than a given amount of energy expressed in thousand British thermal units (MBTUs) per square foot per year.

Standards were mandated by Congress in 1976. Proposed regulations were issued by the Department of Energy last November. Final regulations are due this August. The BEPS are scheduled to be implemented in August of 1981.

There should be no misunderstanding of our position on this issue. NAHB is deeply committed to increasing the energy efficiency of new housing. During the last decade builders have increased the energy efficiency of new housing by 30 percent.

NAHB has built numerous experimental homes in the last 30 years, testing new techniques in cutting energy consumption in homes.

In 1977, NAHB developed voluntary Thermal Performance Guidelines for builders to follow in determining the best mix of cost-effective energy saving measures for each geographic area.

But NAHB strongly opposes the implementation of mandatory energy standards that are impractical, inconsistent, technically deficient and highly inflationary. As proposed today, the BEPS could add thousands of dollars to the cost of constructing a new home without substantially reducing energy consumption.

NAHB urges Congress to delay these standards for two years and subsequently thoroughly test them in a multi-year pilot program to determine their practicality and effectiveness. We believe this delay is justified because:

The BEPS will disrupt the home building industry without saving a great deal of energy.

Builders would be required to run costly and highly technical computer analysis of each home to determine whether they comply with the standards. There are not enough computer analysts or terminals in the country to do the job.

The BEPS are so complex they are beyond the capabilities of most design professionals and engineers, much less the capabilities of small businessmen builders.

The BEPS favor the use of precious gas or oil over electricity which in many cases is the only fuel available and is often generated by noncritical coal, hydroelectric or nuclear power.

The BEPS could add thousands of dollars to cost of constructing new homes at a time when first time buyers are already being priced out of the market.

DOE's economic analysis of the BEPS is based on faulty economic assumptions.

The BEPS are inconsistent. Standards for the mild San Francisco climate are essentially the same as standards for the bitter cold Minneapolis area.

The BEPS have never been tested outside the computer room.

The smaller the home the more thermal protection required, thereby penalizing the first time and lower income buyers more likely to purchase the smaller homes.

PRESIDENT'S ANTI-INFLATION PROGRAM

Finally, let me briefly comment on the President's recent anti-inflation proposals. We applaud any effort at balancing the budget as welcome and long overdue. We feel that Congress has already shown its willingness to act in this area during the Budget Committee action on the First Budget Resolution for fiscal year 1981.

We urge that the budget be balanced through deep, selective spending cuts and federal payroll reductions, focusing first on those unproductive government programs and agencies that sap rather than add to the wealth of the nation. We would support a sharp reduction in the budgets of the regulatory agencies, which are the invisible arm of government that forces private businesses to spend more than $100 billion a year for public purposes.

However, we caution that the Administration and Congress should not rule out the possibility of increasing spending for noninflationary programs that would keep people working and production going in certain industries that are being pealized unfairly by the Federal Reserve Board's tight monetary policies.

Housing and other small businesses would certainly qualify for special relief because they are at the very end of the FED's tight money whip.

The imposition of selective credit controls was welcomed by home builders because since October 6 our industry has been suffering from "quasi credit controls" resulting from the high interest rates being forced upon the industry and the home buyer by the FED.

By imposing the new controls, the President is trying to spread the burden of fighting inflation more evenly across the economic landscape. But we doubt that this action would free up any additional money at reasonable rates for financing the sale and construction of new homes.

We do have one fundamental difference with the Administration on its basic anti-inflation approach. We believe that instead of trying to restrain demand for essential goods such as housing by imposing tight and expensive money policies, the Administration and the Congress should pursue the appropriate mix of fiscal, tax, and monetary policies that would reward increased productivity, encourage investment by business and saving by consumers, and reduce unnecessary and costly government regulations.

Such actions would lower inflation by restoring business and consumer confidence in the economy and by increasing production, employment and competition in the marketplace. It would mean more choices, better products, and lower prices for consumers. As it has been recently stated by the Joint Economic Committee, "we must and we can produce our way out of our economic problems." The specific legislative proposals we suggest today and other long-term remedies which we support are consistent with that principle.

CONCLUSION

Mr. Chairman, thank you for giving us the opportunity to present our views before you today. We stand ready to assist you and the members of this Subcommittee and its talented staff by providing further information and clarification regarding these and other issues of interest. Of course, I would be pleased to answer any questions you may have.

EXHIBIT A

AFFORDABILITY OF HOUSING

[Based on a 30-yr term, $60,000 mortgage]

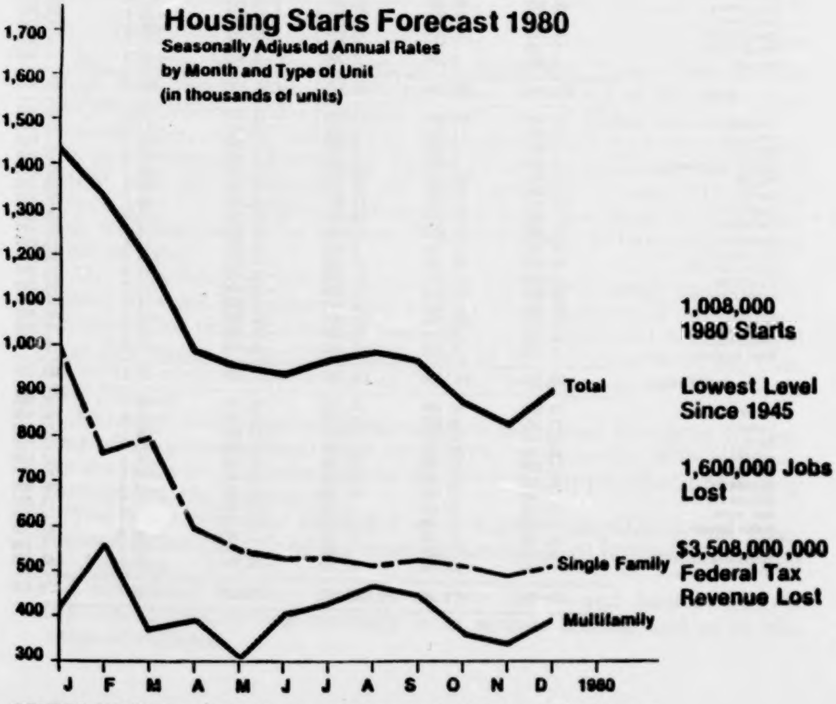
Interest rate	Payment	Expenses [1]	Annual income needed to afford [2]	Families who can afford	
				Number	Percent
9 percent	$483	$215	$33,504	11,786,000	20.6
10 percent	527	215	35,616	10,528,000	18.4
11 percent	572	215	37,776	9,212,000	16.1
12 percent	617	215	39,936	7,896,000	13.8
13 percent	664	215	42,192	6,523,000	11.4
14 percent	711	215	44,448	5,207,000	9.1
15 percent	758	215	46,704	3,833,000	6.7
16 percent	807	215	49,056	2,403,000	4.2
17 percent	856	215	51,408	1,831,000	<3.2
18 percent	904	215	53,712		

[1] Insurance, taxes, utilities.

[2] Assumes 1/4 of income goes to total housing payment.

Source: NAHB Economics Division.

EXHIBIT B



SOURCE: NAHB Econometric Forecasting Service; U.S. Bureau of the Census

NAHB 1980 FORECAST ASSUMPTIONS BY QUARTER[1]

	1980—Quarter			
	I	II	III	IV
AAA bond yields (percent)	12.22	13.25	13.25	12.75
91-day Treasury bill yields (percent)	13.50	15.00	13.50	12.80
Federal Home Loan Bank advances (millions)	−$300	−$1,000	−$800	−$400
FNMA purchases (millions)	+$2,200	+$1,200	+$1,000	+$1,100
Personal income (percent changes at annual rate)	12.00	9.75	8.22	7.92
Prime rate (percent)	16.50	18.50	16.50	14.00
Unemployment rate (percent)	6.2	6.9	7.7	8.2
Subsidized housing units:				
Sec. 8 (multifamily)	13,000	15,000	62,000	22,000
Sec. 235 (single family)	3,900	4,500	4,100	2,800

[1] Forecast date—Mar. 18, 1980.

Source: NAHB Econometric Forecasting Service.

EXHIBIT C

TOTAL HOUSING STARTS 1978-80 AND JOBS LOST BY REGION AND STATE

	1978	1979	1980	1978–80 change		Jobs lost
				Number	Percent	
Total, United States	2,021,000	1,744,000	1,008,900	−1,012,100	−50.1	1,615,400
Northeast	201,000	178,000	96,500	−104,500	−52.0	158,600
Connecticut	15,400	14,000	7,800	−7,600	−49.4	12,100
Maine	7,900	5,500	3,000	−4,700	−62.0	7,700
Massachusetts	20,900	20,200	10,900	−10,000	−47.8	15,500
New Hampshire	8,500	8,200	4,500	−4,000	−47.1	6,900
New Jersey	36,500	34,500	18,300	−18,200	−49.9	28,500
New York	42,800	37,500	20,800	−22,000	−51.4	30,700
Pennsylvania	58,300	47,500	25,500	−32,800	−56.3	50,200
Rhode Island	5,100	5,100	2,800	−2,300	−45.1	3,300
Vermont	5,500	5,200	2,900	−2,600	−47.3	4,000
South	823,000	748,000	466,900	−356,100	−43.3	383,400
Alabama	32,600	28,200	17,200	−15,400	−47.2	25,500
Arkansas	13,600	11,900	7,100	−6,500	−47.8	10,900
Delaware	2,900	2,500	1,500	−1,400	−48.3	2,600
District of Columbia	3,400	1,900	1,500	−1,900	−55.9	3,000
Florida	173,000	182,100	119,900	−53,100	−30.7	87,200
Georgia	47,400	52,700	32,100	−15,300	−32.3	28,100
Kentucky	26,300	22,000	13,500	−12,800	−48.7	21,300
Louisiana	41,400	32,400	19,500	−21,900	−52.92	35,500
Maryland	28,900	24,200	15,000	−13,900	−48.1	21,100
Mississippi	20,100	15,700	9,600	−10,500	−52.2	17,900
North Carolina	66,300	58,400	34,100	−32,200	−48.6	58,200
Oklahoma	29,000	24,800	14,100	−14,900	−51.4	25,200
South Carolina	30,800	28,300	17,200	−13,600	−44.2	23,000
Tennessee	39,300	31,900	19,000	−20,300	−51.7	32,100
Texas	209,200	180,800	115,400	−93,800	−44.6	148,400
Virginia	49,800	42,200	25,300	−24,500	−49.2	40,200
West Virginia	9,100	8,100	5,100	−4,000	−44.0	6,900
North Central	450,000	349,000	192,700	−257,300	−57.2	421,100
Illinois	79,800	50,800	29,800	−50,000	−62.7	78,900
Indiana	41,500	36,200	20,100	−21,400	−51.6	36,900
Iowa	23,400	18,000	9,800	−13,600	−58.1	22,300
Kansas	19,700	15,600	8,800	−10,900	−55.3	17,700
Michigan	63,900	52,400	28,500	−35,400	−55.4	57,600
Minnesota	42,300	33,700	18,000	−24,300	−57.4	40,900
Missouri	38,600	27,500	14,200	−24,400	−63.2	40,900
Nebraska	14,300	12,400	6,100	−8,200	−57.3	13,800
North Dakota	9,400	7,400	3,900	−5,500	−58.5	8,700
Ohio	66,100	57,500	33,500	−32,600	−49.3	51,200
South Dakota	9,300	7,800	4,000	−5,300	−57.0	9,200
Wisconsin	41,600	29,700	16,000	−25,600	−61.5	41,700
West	546,000	469,000	252,500	−293,500	−53.8	452,000

EXHIBIT C—Continued

TOTAL HOUSING STARTS 1978-80 AND JOBS LOST BY REGION AND STATE—Continued

	1978	1979	1980	1978–80 change		Jobs lost
				Number	Percent	
Alaska	10,000	6,400	2,800	−7,200	−72.0	11,600
Arizona	61,200	53,900	29,700	−31,500	−51.5	52,300
California	231,600	206,400	110,400	−121,200	−52.3	178,200
Colorado	44,100	37,000	19,300	−24,800	−56.2	39,900
Hawaii	8,900	9,900	5,300	−3,600	−40.4	5,400
Idaho	13,800	11,300	5,800	−8,400	−60.0	14,300
Montana	8,200	5,600	2,600	−5,600	−68.3	8,800
Nevada	25,400	19,600	10,700	−14,700	−57.9	21,400
New Mexico	14,500	12,300	6,900	−7,600	−52.4	12,400
Oregon	41,400	32,200	17,700	−23,700	−57.2	36,900
Utah	21,100	16,900	8,800	−12,300	−58.3	19,500
Washington	58,700	49,600	28,600	−30,100	−51.3	46,400
Wyoming	7,200	7,600	4,200	−3,000	−41.7	5,300

Note: Components may not add to totals because of rounding.

Source: NAHB Econometric Forecasting Service; data analysis by NAHB Economics Division.

EXHIBIT "D"

Total demand for housing in the 1980's

Total demand: 23 million units:

	million
Replacement of accidental losses, depreciation and second homes	6.33
Additional vacancies	1.40
Immigration	1.39
Headship increase	6.46
Natural population growth	7.42
Total	23.00

Mr. SMITH. My name is Herman J. Smith and I am a homebuilder from Fort Worth, Tex., testifying today on behalf of the more than 121,000 members of the National Association of Home Builders.

Accompanying me is Robert D. Bannister, senior staff vice president for governmental affairs, and James Schuyler, legislative counsel. I might add, Mr. Chairman, I am also pleased to present Mr. Harry Pryde, our vice president and secretary from the State of Washington, who happens to be in town. We are pleased to have him present with us today.

Mr. Chairman, as you are aware, our industry is made up predominately of small businessmen and women. Forty percent of our builders construct less than 10 houses a year; only nine-tenths of 1 percent build over 500 houses a year. Over 75 percent of our members build less than 25 units a year, and over one-half of our builders employ fewer than five persons.

Although new residential construction accounted for about 4.7 percent of the gross national product in 1979—representing $108 billion—we are not a big business despite the powerful ripple effect of housing throughout the economy.

You have correctly identified us a highly competitive and fragmented industry—one of the most important small business industries in America.

I am afraid that my message is very simple and deeply disturbing—the homebuilding industry is in serious trouble and is on the verge of collapse.

And, as in other housing declines in the past, millions of jobs of other small businessmen and their employees are in jeopardy in industries dependent on housing production. And equally important, potential home buyers throughout the country—particularly young families—are being priced out of the homeownership market and will be unable to achieve the dream of owning their own homes.

I believe we could easily move into a short-term outlook for housing. I will give you a quick update as reported in published data and then remind you of what has happened in the last few days throughout our industry.

Later today, housing starts figures for March will be released by the Department of Commerce. We expect them to continue the decline which has been registered over the last few months.

For February, new housing figures which were released that show a decline of 10 percent below the rate of January 1980, and 26 percent below the February 1979 rate.

We have some charts and figures attached to our testimony that will show some of the basic figures as we go through it. But February start figures do not reflect the seriousness of the current housing situation. The impact of the mid-February Federal Reserve Board credit tightening is not taken into account.

One of the problems is that interest rates of 16 percent to 17 percent and fewer than 5 percent of the American families can qualify for an average $60,000 mortgage. I might add we have an exhibit attached to our testimony, exhibit A, which shows the breakdown of these particular figures and why at 16 percent we are talking roughly about 4.8 percent of the American families that can buy a typical or a medium-priced house today.

We also have a steadily increasing inventory. This inventory translates into over $9 billion worth of unoccupied housing at today's average purchase price. The total housing inventory, including those units under construction, or in the pipeline, total almost 400,000. This inventory is as high during the inventory during the 1974–75 recession.

I might add one thing of interest, Mr. Chairman, is the fact there is a market for this housing that was unavailable in 1974–75. The problem is that they cannot qualify at today's interest rates.

Sales of new homes have plummeted, with some areas of the country down 80 percent. If you will remember in the last few days, over 2,000 members of NAHB visited Washington and I am sure they visited with most of you. They brought you up to date on what was happening in your area.

This past week I have been with builders in Chicago; Jackson, Miss.; Fort Worth, Tex., and I can tell you in the last 30 days throughout the country, new starts, for all practical purposes, have ground to a halt.

At 20 to 22 percent construction financing rates and at 16 percent mortgage interest rates, have brought the industry to a complete halt.

The entire residential industry is on the verge of being shut down. At 16 percent—today's prevailing rate—the payment on a 30-year $60,000 mortgage loan is $807 a month for principal and interest. This compares strikingly with rates 18 months ago when mortgages were at 10 percent. The going mortgage rate for a $60,000 loan then was $527, a $280 difference. This translates to a difference of over $3,300 a year. At a complete 30-year amortization payout, you are talking about an additional $108,000 on this $60,000 mortgage due to the present rates.

It is hard to explain to young couples trying to buy housing today, how that fights inflation.

Based upon the NAHB econometric forecasting service projections, which optimistically assumes a decline in interest rates this year, we predict a level of 1 million housing starts in 1980. If you will notice, Mr. Chairman, we have exhibit B attached to our statement. You can look at this chart later, but it asumes a certain downward trend in prime rates for the balance of this year to even obtain a 1 million start figure. What does this mean? More specifically this level of activity will have a great impact on the national economy. It will result in the loss of 1.6 million jobs; the loss of $27.5 billion in wages; the loss of over $3.5 billion in Federal tax revenues at a time we are attempting to balance the budget and $7.5 billion in combined Federal, State, and local revenues. But much more is at stake. Our inability to produce housing to meet the demands of the American people could well upset the social fabric of our country. Without a doubt, the result will be highly inflated housing costs when this industry recovers during the early 1980's.

Thousands of skilled craftsmen will seek employment elsewhere and never return. Consequently, we will have to retain a new work force when economic conditions improve. Building product manufacturers will delay indefinitely plans to expand their production capacities.

Let me add, Mr. Chairman, that this is happening today. We are seeing, according to the Timber Institute last week, over 100,000 layoffs in the last 30 days in the timber mills.

Mr. LaFalce. I believe this is an especially important point. We are considering, whether in this subcommittee or on other subcommittees, steps that should be taken to cope with the problem now. I think it is necessary to look at what would happen if we do not cope with the problem now in some way.

You say that there will be such a demand later on that it will be unbelievably inflationary. I think it is important that you document that in some way. I would appreciate that.

Mr. Smith. Thank you. We will be pleased to do so.

Mr. LaFalce. Without objection, so ordered.

[Housing forecast and economic assumptions follow:]

III. Housing Forecast

A. TOTAL HOUSING STARTS

In the 1980's the United States is expected to build 19.3 million new homes. Add to this about 3.3 million mobile home shipments for a total of 22.6 million housing units.

New housing starts will thus average close to 2 million per year, a feat never accomplished before. In a historical perspective these are the starts figures for the past three decades.

TABLE 7.—TOTAL HOUSING STARTS BY DECADE, 1950-90

Decade	Total housing starts	Percent change
1940-50	7,153,000	
1950-60	14,666,000	+105.0
1960-70	14,065,000	-4.1
1970-80	17,631,000	+25.4
1980-90	19,300,000	+9.7

Source: U.S. Bureau of the Census: Housing and Population Census, 1970, and Current Population Reports, p. 25, table 16.

The first half of the 1980-1990 decade will be slow for starts, and in that period only slightly above 9 million units will be built. The 1980, 1981 and 1982 years will average only 1.4 million units.

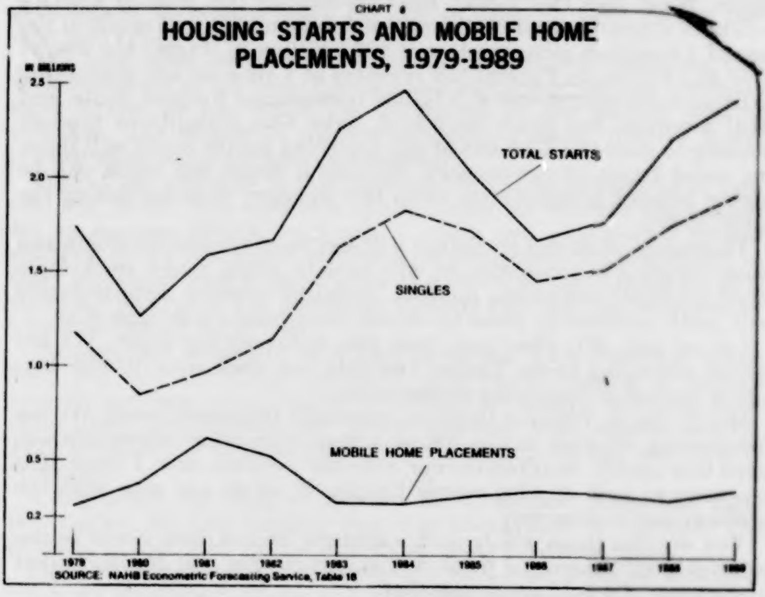


CHART 8

HOUSING STARTS AND MOBILE HOME PLACEMENTS, 1979-1989

SOURCE: NAHB Econometric Forecasting Service, Table 18

TABLE 1.—ECONOMIC ASSUMPTIONS, U.S. HOUSING FORECAST, 1979-89

	1979	1980	1981	1982	1983	1984
Personal inc per cap	$8,783	$9,475	$10,287	$11,226	$12,224	$13,489
Percent change	12.10	7.88	8.56	9.13	8.89	10.35
Sp inc cap, 72 dollars	$4,430	$4,302	$4,342	$4,464	$4,598	$4,690
Percent change	0	−2.90	0.95	2.80	3.00	2.00
Consumer Price Index	219.8	243.1	264.5	283.6	301.7	328.6
Percent change	12.50	10.60	8.80	7.20	6.40	8.90
Employment (thousands)	87,425	85,567	83,681	84,817	87,353	89,953
Employment rate (percent)	6.34	7.80	8.20	7.60	6.30	5.50
Population (thousands):						
15 to 24	41,354	41,224	40,632	40,197	39,467	38,790
25 to 34	34,837	36,000	37,290	27,689	38,368	39,031
35 to 64	68,886	69,540	70,150	71,800	73,128	74,373
65 plus	24,537	25,031	25,472	26,889	26,329	26,826
All ages	219,846	221,770	223,823	225,954	228,120	230,303
Interest rates (percent):						
Prime rate	12.50	14.25	10.00	8.50	7.75	10.40
91-day Treasury bills	9.75	11.65	9.80	9.45	7.60	10.00
AAA bond rates	9.65	10.35	9.65	9.20	8.20	9.40
Savings and loans	8.70	8.65	8.80	8.95	8.80	8.69
Commercial banks	7.50	7.85	8.05	8.15	8.05	7.95

	1985	1986	1987	1988	1989
Personal inc per cap	$14,626	$15,851	$17,063	$18,536	$20,181
Percent change	8.43	8.37	7.65	8.63	8.97
Sp inc per cap, 1972 dollars	4,642	4,710	4,852	5,036	5,200
Percent change	−1.00	1.45	3.00	3.80	3.46
Consumer Price Index	350.1	387.1	407.3	429.3	454.0
Percent change	9.30	7.80	5.20	5.40	5.97
Employment (thousands)	91,201	91,842	94,621	98,796	103,510
Employment rate (percent)	1.80	6.70	5.40	5.10	5.0
Population (thousands):					
15 to 24	38,214	37,658	36,877	35,986	35,084
25 to 34	39,687	40,273	40,691	40,946	41,050
35 to 64	75,493	76,787	78,098	79,527	81,038
65 plus	27,469	27,927	28,486	28,984	29,460
All ages	232,491	234,674	236,840	238,975	241,074
Interest rates (percent):					
Prime rate	10.65	8.50	7.00	7.25	7.50
91-day treasury bills	10.40	8.80	6.75	6.90	7.10
AAA bond rates	9.75	8.80	7.10	7.15	7.25
Savings and loans	8.75	8.65	8.35	8.20	8.40
Commercial banks	8.05	8.00	7.50	7.40	7.45

TABLE 16.—ECONOMIC PROJECTIONS, 1979-89

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Starts:											
Single family	1,162.41	869,000	982,000	1,148,900	1,636.67	1,826.58	1,714.66	1,461.48	1,514.08	1,760.48	1,910.69
Multifamily	531.82	596,800	910,000	539.09	618.65	640.[illegible]0	323.37	227.06	260.72	443.26	511.72
Total	1,694.23	1,266,200	1,492,700	1,687,900	2,255.32	2,466.88	2,038.03	1,688.54	1,774.80	2,203.74	2,422.40
Mobile home placements	261.63	323.66	359.03	354.63	293.53	290.29	323.36	340.41	331.38	307.87	358.58
Sales of existing homes	3,655	3,005	2,964	3,468	4,942	5,828	5,934	5,621	5,783	6,539	7,205
Primary family households:											
18 to 24	3,671	3,436	3,222	3,024	2,851	2,712	2,534	2,327	2,194	2,127	2,052
25 to 34	13,779	14,093	14,471	14,591	14,917	15,318	15,664	15,822	16,117	16,501	16,780
35 to 64	32,296	32,662	32,991	33,812	34,463	35,033	35,526	36,107	26,714	37,366	38,039
65 plus	8,467	8,600	8,825	9,187	9,529	9,774	9,937	10,155	10,515	10,881	11,130
Total	58,213	58,791	59,508	60,613	61,760	62,837	63,661	64,412	65,540	66,876	68,011
Primary individual households:											
18 to 24	2,696	2,801	2,858	2,996	3,157	3,274	3,265	3,313	3,361	3,383	3,389
25 to 34	3,879	4,121	4,378	4,644	4,953	5,194	5,256	5,399	5,561	5,651	5,684
35 to 64	6,238	6,139	6,118	6,456	6,817	7,033	7,024	7,021	7,221	7,501	7,741
65 plus	7,368	7,579	7,729	7,913	8,147	8,411	8,662	8,869	9,133	9,433	9,767
Total	20,181	20,640	21,084	22,009	23,874	23,912	24,227	24,601	26,276	25,969	26,581
Total, households	78,394	79,431	80,592	82,622	84,835	86,749	87,888	89,013	90,816	92,843	94,592
Single family	53,779	54,257	54,876	56,567	58,569	60,409	61,358	62,188	63,733	65,587	37,254
Multifamily	20,539	20,835	21,106	21,288	21,270	21,224	21,243	21,357	21,447	21,481	21,465
Mobile homes	4,076	4,338	4,610	4,827	4,975	5,116	5,286	5,468	5,635	5,774	5,873
Total stock:											
Single family	56,409	57,458	58,176	58,892	59,823	61,340	63,044	64,632	65,964	67,346	68,972
Multifamily	22,774	23,078	23,304	23,376	23,582	23,965	24,365	24,445	24,428	24,444	24,643
Vacancy rate:											
Single family	0.047	0.056	0.057	0.040	0.021	0.015	0.027	0.038	0.034	0.026	0.025
Multifamily	0.098	0.097	0.094	0.089	0.098	0.114	0.128	0.126	0.122	0.121	0.129
CPI rental components	184.3	202.8	217.9	233.8	253.4	279.9	307.1	330.0	349.7	373.3	401.9
CPI home ownership	257.5	290.5	306.7	307.1	313.6	341.6	383.2	405.2	405.7	403.1	431.0
Price new single family home	63,308	66,138	68,694	74,698	85,196	98,974	107,829	14,966	124,172	139,233	156,537
Price existing single family home	53,843	58,840	60,979	66,735	74,052	84,991	93,438	100,054	108,614	121,018	136,307
Land price, FHA site	8,432	9,088	9,745	10,426	11,120	11,897	12,719	13,537	14,308	15,083	15,881
Median home, square feet	1,604	1,564	1,575	1,647	1,714	1,742	1,730	1,739	1,812	1,863	1,907

TABLE 17.—U.S. POPULATION AND HOUSEHOLD TRENDS—1970-90 PROJECTED

[In millions]

	1970	1980[1]	1990[1]	Net change (percent) 1970-80	Net change (percent) 1980-90
Population:					
Total	205.0	222.2	243.0	17.2	21.3
18 yr and older	135.3	160.2	178.5	24.9	18.3
Percent 18 yr	66.0	72.0	73.5		
Households:					
Total	63.5	78.9	93.8	15.4	14.9
Families	51.5	59.3	69.0	7.8	9.7
Non family	12.0	19.6	24.8	49.0	35.0
Percent nonfamily	18.8	24.8	26.4	49.0	35.0
Age of head of household:					
Below 30	10.7	15.3	16.2	4.6	.9
30 to 44	17.5	22.6	31.6	5.1	9.0
45 to 64	23.2	24.7	26.1	1.5	1.4
65 and older	12.1	16.3	19.9	4.2	3.6
Total	63.5	78.9	93.8	15.4	14.9
Percent distribution by age of head of household:					
Below 30	16.9	19.4	17.3	29.9	6.0
30 to 44	27.5	28.6	33.7	33.1	60.4
45 to 64	36.5	31.3	27.8	9.7	9.4
65 and older	19.1	20.7	21.2	27.3	24.2
Total	100.0	100.0	100.0	100.0	100.0

[1] Estimated. Estimates represent the likely Bureau of the Census projection (series II).

Source: U.S. Bureau of the Census: Housing and Population Census, 1970 and current population reports, p. 25.

TABLE 18.—NET CHANGES OF ADULT POPULATION BY AGE BRACKETS, BY DECADES, 1950-90, PROJECTED

[Population in millions]

		Age brackets				
		Rental market		Homebuying market		
	Population 18 yr and over	18 to 29	30 to 39	40 to 49	50 to 64	65 and over
Decade:						
1950-60	11.0	−1.5	1.5	3.2	3.5	4.3
1960-70	19.3	11.4	−1.7	1.5	4.7	3.5
1970-80[1]	24.9	10 1	8.4	−1.4	3.0	4.8
1980-90[1]	18.5	−3.2	9.0	8.5	−.7	4.9

[1] Estimated.

Source: U.S. Bureau of the Census and Uriel Manheim.

Mr. SMITH. In other aspects of our testimony we talk about the demographics and the needs for 2.3 starts per year. As I have mentioned here, this inflationary increase is based on the 1 million starts, compared with the 2.3 million need. This will make inflation in the 1970's for housing look like child's play compared to the inflation in housing in the 1980's. But we will, Mr. Chairman, document these demographics and have them available to you.

There are two other facts which I believe must be kept in mind when evaluating the current crisis. First, the underlying demand for housing is very strong when 41 million Americans will reach the prime home-buying age of 30. This compared with about 31 million who will have reached the age of 30 during the 1970's. The rate of new household formation will be 25 percent higher in the 1980's than during the last decade. This increased rate of family formation is largely the result of the postwar baby boom and we predict that there will be no significant drop in housing demand until the 1990's when the baby bust generation of the 1960's enters the housing market.

Of course, the 23 million housing needs will be needed during this 10-year period as indicated on our exhibit D, that is attached to our testimony. This is broken down in several categories, which we can substantiate.

Second, the crisis in rental housing and the inability of the private sector to develop and operate multifamily housing in today's market will mean that rental housing will not be able to meet any substantial portion of the existing demand.

Let me briefly outline the problem. The numbers are quite startling. Statistics compiled by NAHB's economics department show that in the last 3 years, the annual net loss of rental housing has been about 1.5 percent. Last year, the loss of rental units exceeded the number of new units constructed by about 20,000.

In 1979, of about 430,000 multifamily rental units built, only about 210,000 were privately financed. This concerns us. This has increased, Mr. Chairman, over the last 5 years to the point that over 50 percent of the units were subsidized low- and moderate-income housing and FHA-insured multifamily housing.

Mr. LaFalce. I wonder, Mr. Smith, if you could supplement your material with a breakdown over the years, going back to 1975, of what percentage of the multifamily units were privately financed and what percentage needed governmental assistance.

According to your figures, 220,000 units had some type of Government subsidy or assistance, which means more than 50 percent.

What is a rough estimate of 1970?

Mr. Smith. We could go back to the 1960's and start out at 3 percent and chart it forward to the point where we are getting to over 50 percent.

Mr. LaFalce. I would appreciate that.

Also, if you view that as a disturbing trend, I would ask you to reconcile what you perceive to be a disturbing trend with what I know have been your requests for greater governmental assistance.

Mr. Smith. The top paragraph of the next page refers to that.

Mr. LaFalce. Very well.

Without objection, so ordered.

[Material requested follows:]

PRIVATE RENTALS VERSUS MULTIFAMILY STARTS

[In thousands]

Year	Total multifamily	Condos and other for sale	Total rentals	FHA multis	HUD Public and sec. 8	Total private rentals
1964	558.3	NA	NA	98.7	24.6	
1965	509.1	NA	NA	35.7	32.2	
1966	385.2	NA	NA	79.3	30.2	
1967	447.7	NA	NA	37.8	32.6	
1968	608.2	NA	NA	79.4	66.4	
1969	656.2	NA	NA	79.7	67.0	
1970	628.7	71	557.7	182.0	95.4	283.3
1971	951.2	147	794.2	226.8	68.5	498.0
1972	1,047.5	247	800.5	172.4	40.0	588.1
1973	913.9	267	646.9	88.6	25.7	551.6
1974	449.7	138	309.7	37.7	16.7	265.3
1975	268.3	45	223.3	28.0	15.2	180.1
1976	375.1	64	311.1	64.7	28.0	218.4
1977	536.1	91	445.1	75.1	96.5	273.5
1978	587.0	132	455.0	84.2	144.0	226.8
1979	551.0	173	378.0	73.5	153.4	150.9

Source: Bureau of the Census, Department of Housing and Urban Development.

Mr. LaFalce. You may proceed.

Mr. Smith. The recent General Accounting Office report on rental housing released on November 8, 1979, found that the shortage of affordable rental housing is so acute that immediate congressional action is needed. GAO found that multifamily starts in the private sector last year were at their second lowest rate in 20 years. The private sector would provide only about 25 percent of the new rental units, and that most of these would be for high-income tenants.

We predict that 75 percent of the multifamily starts this year will be financed by the Government which represents a troublesome trend and a tremendous increase over the 22 percent in 1972.

Mr. LaFalce. Could you chart that also, please?

Mr. Smith. Yes; that is included in the previous chart.

On the short-term solutions: What can be done in the next 90 to 120 days to head off this approaching housing depression and the large layoff we mentioned a while ago?

Let me begin by saying that as long as interest rates remain at the 16 to 17 percent levels, the housing industry will remain in serious trouble.

But by working together, the Congress and the administration, there could be some temporary tax relief. We have testified before pertaining to the Brooke-Cranston tandem program which provides below market interest rate mortgages for new homes and unoccupied homes in the housing inventory.

I might add, Mr. Chairman, this is at a time when the American home buyer is locked in with 16 percent or 17 percent interest rate. It is a time when the inventory is locked in, due to the fact that the buyers cannot afford this inventory; and bankruptcies are developing.

I might add another thing that has an impact on the budget is that 3 percent of the builders in this country will go bankrupt according to our statistics. It will have a tax impact this year of $5.8 billion on the deficit.

Mr. LaFalce. Are you telling me that if 3 percent of the homebuilders go bankrupt, there will be a shortfall in Government revenue for fiscal year 1981 of approximately $5.8 billion?

Mr. Smith. Yes. There are two things that you should take into consideration. When you say 3 percent, that is average producers of inventory housing. No. 2, in case of a failure, you have the averaging back for the last 3 or 4 years that the builder would normally go to. That is for the 1981 tax impact.

By the time you take these two matters into consideration, according to our economics department, you are looking at a $5.8 billion downfall for that fiscal year, 1981.

Mr. LaFalce. That is an interesting statistic. Please give me a written explanation of how that works.

Mr. Smith. We will be pleased to do it.

Mr. LaFalce. Without objection, so ordered.

[Material requested follows:]

Possible Tax Losses Due to Failures of Construction Firms and Loss of Profits in 1980 Utilizing 5-Year Carryback and 3-Year Carryforward Provision of Tax Law

Total volume of residential industry was $110 billion in 1979. Excluding land ($16 billion), leaves $94 billion direct cost.

Failures and bankruptcy would increase by about 3 percent, or 30,000 firms would either go bankrupt or get out of business. This equals about $10 billion worth of losses. Assuming a total profit of residential industry at $8 billion (8 percent of $100 billion) and assuming that one-half of this will be lost, equals a net loss of about $4 billion.

	billion
The total of $14 billion divided into:	
$10 billion in corporations at 48 percent (loss to Treasury)	$4.8
$4 billion in others at 25 percent (loss to Treasury)	1.0

The total loss to Treasury, by direct losses of profits and due to failures by the residential industry in 1980 = $5.8 billion.

Mr. SMITH. So we keep the record straight on Brooke-Cranston, because I hear a lot about it pro and con, HUD officials have described Brooke-Cranston before the Senate Banking Committee as virtually a no-cost program to the Government over the long term.

Of course, we well realize, as you do, how the Brooke-Cranston funding comes about on the purchase and the resale and we know that the timing is always of a major consequence.

But even back on February 25, Federal Reserve Board Chairman Paul Volcker recognized in hearings, and I quote—in answer, by the way, to a question pertaining to the reactivation of Brooke-Cranston:

> Maintaining a certain level of activity in (the housing) industry is not at all inconsistent with an attack on inflation over time. You don't want to close down the whole industry and then have to build it up again as soon as money becomes more available.

I might add that we fully concur with the chairman on this particular matter. Even on February 25 we were predicting a potential downturn that occurred in the middle of April. It is more serious today than it was at the time the chairman testified in the Senate Banking Committee on February 25.

We will now go forward on another matter of tax-exempt revenue bonds. I know this has been discussed heavily in both committee and on the floor. We did have a major goal to preserve the tax-exempt revenue bond program for single family housing during this downturn in housing activity. If you will note on page 12 of our testimony we have this broken down in the income side to the Government pertaining to $1 billion in housing construction. Of course, this was not taken in consideration by Treasury when they testified on the other side of the fence.

I would like to call to your attention the $34.6 million in Federal corporate income tax revenue for every $1 billion in housing construction.

Mr. LAFALCE. May I ask a question which the executive vice president from New York might be better equipped to answer?

I know the NAHB opposed the tax-exempt revenue bond bill that passed the House of Representatives. But by the same token the New York State Association of Home Builders favored it.

I am curious as to what the rationale of the New York State Association of Home Builders was that differed from the national association.

Mr. SMITH. Your people visited with us on that. Let me say that, of course, as you know, the bill is very complicated. We can go on through with a lot of details with the "sunset" provision, and so forth.

If you are in a particular State with a large issue pending, and if the legislation, as presented, would allow this issuance to proceed and obtain some temporary relief, it is understandable to fight to obtain this temporary relief.

It is our opinion that although that is well and good for the States that would be able to proceed at this time under the home provisions, we are hopeful that by the time this comes through the Senate and goes to a Senate-House conference committee, that a more reasonable approach to revenue bonds will be taken that are not as restrictive as the Ullman bill that will allow New York and others to spread out a well-planned program over a period of years.

Let me just mention the building energy performance standards—BEPS—in our written testimony, which I think pretty well summarizes my testimony.

Let me just say that as proposed today BEPS would add thousands of dollars to the cost of construction of new homes without substantially reducing energy consumption.

Let me mention, also so there is no misunderstanding, Mr. Chairman, of our position. NAHB is deeply committed to increasing the energy efficiency of new housing. During the last decade builders have increased the energy efficiency of new housing by 30 percent. But we are urging rather than to use a computer model which has never been tested outside the computer room, that Congress delay these standards for a period of time so that a pilot program to determine the practicality and effectiveness can be put into full force and effect, or we are going to be in trouble.

Finally, let me briefly comment on the President's recent anti-inflation proposals. We applaud any effort at balancing the budget as welcome and long overdue. We urge that the budget be balanced through deep, selective spending cuts and Federal payroll reductions, focusing first on those unproductive Government programs and agencies that sap rather than add to the wealth of the Nation. We would support a sharp reduction in the budgets of the regulatory agencies, which are the invisible arm of Government that forces private businesses to spend more than $100 billion a year for public purposes.

I would think, Mr. Chairman, in conclusion that we are very concerned in the area of production. I was especially pleased to note your opening testimony regarding productivity where the task force stated that for every 1 percent productivity goes up, the inflation rate will come down at least 1 percent. We certainly think that is accurate. We believe that it would be good, as recently stated by the Joint Economic Committee "we must stand and we can produce our way out of our economic problems."

The specific legislation we suggest today and other long-term remedies we support are consistent with that principle and we are hoping that the homebuilding industry and its related ripple effects is allowed the opportunity to produce itself out of the inflationary spiral that we are now in.

Thank you, Mr. Chairman. We will be glad to answer any questions that you and the members of the committee might have.

Mr. LaFalce. Thank you.

Mr. Bereuter?

Mr. Bereuter. Thank you, Mr. Chairman.

I guess I will not say too much about tax-revenue bonds. Your business, of course, is building. You are not responsible for the kind of abuses we had in the housing revenue bond market. But they were substantial and was the same kind of cycle we went through with the industrial revenue bonds in this country about 15 years ago.

The abuses bring controls. I wonder about your statistics relating to tax revenue coming from production, whether or not that is entirely accurate and that the assumption is that without the tax-exempt mortgage bonds, housing bonds, we are not going to have that activity at all, and therefore, you are going to have an absolute loss to the Treasury.

I just do not reach that same conclusion.

I understand that you are trying to make the best case on this matter. I think perhaps that is an overextension.

Do you have any comments on that?

Mr. SMITH. I would be pleased to respond.

If you note, we will be comparing this to the $1 billion in housing construction that would be produced. The testimony to Mr. Ullman's Ways and Means Committee included statistics that our economics department used that were backed up with data from the Labor Department and from other Government data.

I believe Treasury testified that we had approximately a $24 to $26 million loss to the Treasury of every $1 billion on the lack of tax revenue income.

There are statistics——

Mr. BEREUTER. I would not argue with the statistics.

Mr. SMITH. These statistics were developed by the Labor Department. In our opinion, these were offset due to the taxes paid and unemployment payments that would not be necessary.

My further answer would be that based on the present 16 percent, the tax-free bonds would be the only activity going on now.

Mr. BEREUTER. I would not argue that 1 million housing construction will have the kind of results that you indicate there. I would not argue that at all.

I am just saying that it is unrealistic to assume that you are not going to have any activity or any substantial activity without tax-exempt bonds.

I hope that perhaps you will consider our problem. Tax-exempt bonds are coming to a dominant position in the bond market today.

I want to go into something else where I think you can be of substantial help. That is to provide some details about the performance standards. I have been interested in this subject for a while.

I am sure you delivered some testimony to the two Banking Committees on the problems.

I happen to think, for instance, that our most energy efficient buildings are not residential units but they are commercial units.

Mr. SMITH. I might add that we have a gentleman from Lincoln, Nebr., Mr. Peterson, who is very effective on this project. We have reams of data that we will certainly be glad to——

Mr. BEREUTER. He is my constituent and is in frequent contact with me.

I would like from you, or from any of you gentlemen here, a few examples of the inconsistency or the impractical nature of BEPS as applied to residential units which you might be involved with in construction.

Give me a few examples.

Mr. **Smith.** Let me give you one good one. I am kind of like the fellow who said "Pardon my reference to personal experiences, but they are the only kind I have ever had."

In Fort Worth, Tex., about 40 miles outside of Fort Worth, we have a new atomic energy plant underway. We have great lignite coal deposits in east Texas that are providing electric generation in the area.

However, until the new BEPS standard, the Dallas-Fort Worth area cannot use all the electricity. We will have to use either oil or gas. Consequently, the onstream effect of the cheaper lignite and the cheaper energy from the reactor has not been taken into consideration.

This is a good example of what a computer does. It cannot look down the road to practicality, if the information is not fed into it accordingly.

If you will note here, we are talking about 19 building classifications and 78 climate types.

Mr. **Bereuter.** And yet you say that Minneapolis and San Francisco have the same standards applied despite that?

Mr. **Smith.** Yes, sir, that is in our testimony.

Mr. **Bereuter.** That is a little hard to justify. Certainly, on the surface it seems hard to justify.

Mr. **Smith.** One of the things we find to be very interesting here is that builders, over a period of years, are practical or they do not survive. One of the best ways for industry to take a hard look at this is to set some pilot programs up throughout the country and monitor them for a year.

One thing we must remember is that there are 75 million residential units in the country today. We are not going to build many next year.

So, the effect will probably be less than 1½ percent so far as the new starts are concerned in relation to the older starts, which means that you are not going to retrofit everything in the present housing stock.

So, we support a 1 year pilot study, with 2 years of actual study, to be sure what the computer model is predicting is true.

Mr. **Bereuter.** You have made that recommendation, I assume, to the Banking Committees. Have you had any reaction?

Mr. **Smith.** We also met with Secretary Duncan. I will say everywhere we have gone we have received very good response.

One of the problems here, as you know, is that Congress has mandated this schedule. We think Congress should back off that mandate in the next few weeks so that in August the trigger is not started to the point that we can look at this problem in a cost-effective way.

Mr. **Bereuter.** But I understand you would recommend a multiyear pilot program and I assume one that is spread throughout the climatic regions of the Nation?

Mr. **Smith.** Yes; and we will work with Energy in every way. We will make housing available. We will let them do the monitoring. But let us prove the point before we spend big money in that area.

Mr. **Bereuter.** Finally, I would like to ask about your testimony on page 14. You mentioned a requirement for a computer analysis of each home. Is it each home or each model that a builder may be provided? I assume it is the latter?

Mr. Bannister. One of the problems of the entire standard is the fact that for years the building industry has operated under the prescriptive approach, the prescriptive standard, and they are going to a performance standard.

DOE is saying that we are going to have you save *x* number of Btu's per square foot, but not tell you how to get there. So, the problem is how every individual builder knows whether or not he is saving that number of Btu's per square foot to meet the standard. Therefore, there will have to be a computer analysis of each home that is being built by the builders. If it is a larger builder, yes. If he has identical homes in a tract that are all the same, he can use that same computer model.

But the backbone of the industry is the smaller builder, the ones that are building 5 and 10 houses a year in different locations. So, they will have to go to an architect and have a special design of the home put through a model to understand what the energy savings would be.

Mr. Bereuter. One of the criticisms of home builders and many other development interests have leveled against the housing agencies and the local political subdivision programs is their slowness, their failure to go to performance standards in construction.

How do you reconcile the long-term thrust of your own association with the kind of problems we are now finding in performance standards in the area of energy?

Mr. Bannister. I think it is inherently one of time frame. We are not saying we do not want to go forward with the standards. We are saying we have to test them first to see the practicality to see whether they are going to be workable and actually save the energy that DOE says they are going to save. We are not saying no to a performance approach, but getting from the prescriptive that every house in this country has been built under since the homes have been built.

To this new approach, there has to be some study and analysis in the pilot program. We are not saying the performance rule is wrong. We are saying to study it first.

Mr. Bereuter. I think you make the point very well. I happen to be sympathetic to what you are saying. I want this on the record.

I think any mandate from Congress in this area without any kind of test pilot program before the mandate was wrong. It is now coming back to haunt us.

Mr. LaFalce. Please refresh my recollection as to that law.

Mr. Bannister. It was the Energy Supply and Production Act of 1976. It essentially asked DOE and HUD to come up with a building energy performance standard. Then they set up a timetable.

Mr. LaFalce. You have no objection at all to performance standards, as I understand it; correct?

Mr. Bannister. We are having some very severe problems with the standards as they have now been documented——

Mr. LaFalce. I mean the concept of performance standards.

Mr. Smith. No; in fact, we have some thermo standards we have worked on through our research home for the last several years. Standards as a whole—no, sir.

Mr. LaFalce. Is there any legislative mandate of a timetable?

Mr. Smith. Yes, sir, your final regulations are due this August.

Mr. LaFalce. Is that the statutory mandate?

Mr. SMITH. Yes, sir, I believe it is August 11. The BEPS are scheduled then to be implemented in August 1981, which means that the builders coming onstream with this next year would fall under this. Our large problem——

Mr. LAFALCE. What is the legislative vehicle for a temporary moratorium?

Mr. BANNISTER. We have some legislation that we would like to submit to the committee for review that would delay the designing of the standards to make sure they are accurate and then test it on a pilot basis.

Mr. LAFALCE. What is the legislative committee that would consider that?

Mr. BANNISTER. They have joint jurisdiction—both Banking and Interstate and Foreign Commerce. On the Senate side it is Energy and Banking Committees.

Mr. SMITH. You know, several committees in the House are involved with us.

Mr. LAFALCE. The hosting subcommittee is having meetings. What is your reading on the staff recommendations? I am talking about the form of the moratorium?

Mr. BANNISTER. I think the chairman has expressed some concern, as have the minority members about the current timetable. Whether or not the caucus this afternoon is considering that, I am not sure.

Mr. LAFALCE. Could you give me the actual language that you have worked out?

Mr. BANNISTER. Yes.

Mr. LAFALCE. So far as the tax-exempts are concerned, you made a statement that somewhat surprised me. You hoped that the Senate would come up with what you perceive as a better bill than the House did.

It is my understanding that the Treasury expected the Senate might pass something more akin to the original Ullman bill. What is your reading on that?

Mr. SMITH. I do not believe they find a real support for that position. However, let me just say that we would hope not.

We have testified in Senator Williams committee on this subject when his bill was originally introduced. In answer to the previous question, let me say that we are not against a fair and equitable program for all people. But the Williams bill is certainly less restrictive, especially on State agencies than the bill passed by the House. We know what the Treasury is hoping for, but we do not think their wish list is quite that large.

Mr. LAFALCE. Let us go on to Brooke-Cranston just a bit. Would you explain to the subcommittee very briefly how Brooke-Cranston would work?

Mr. BANNISTER. In 1974, Congress passed the Emergency Housing Act to deal with the housing downturn. Brooke-Cranston is for the stimulus of the housing market. It is program where GNMA will purchase mortgages at a subsidized rate. The mortgages are later sold on the secondary market.

The last time the program was used, approximately $6.4 billion was in initial outlays. After the mortgages were sold, according to

GAO, it cost the Federal Government about $412 million from those $6.4 billion for single families.

That did not consider the revenue gain from the construction of those 190,000 units that were stimulated under the old program. According to the figures from those 190,000 units, the Federal income tax was $426.2 million; in corporate taxes, $410 million.

So, those taken more than offset the $412 million that GAO said it cost to administer the program the last time it was used.

Mr. LaFalce. There are three things that are going to be necessary to estimate. First of all, we are going to have to change the Brooke-Cranston formula because the ability to subsidize right now is pegged at 7.5 percent.

Mr. Smith. We have testified previously in House committees that this should be increased.

Mr. LaFalce. I understand that. But even if that authorization were created, there would have to be, as I understand it, a decision by HUD to implement it. There would have to be an appropriation. The initial outlay would have to be $6.4 billion, roughly, or the extent the GNMA participation. There again you are adding an immediate expenditure to the budget which would only have a feedback at whatever time those mortgages were sold on the secondary market; is that correct?

Mr. Bannister. The recapture occurs at the time they sell them on the secondary market.

Mr. LaFalce. What is the time period?

Mr. Bannister. They wait until the interest rate comes down so they can make a profit.

Mr. Smith. Let me give you an example. Of course, at the time this was set up we did not have a mirror game going on budget figures in 1974–75 like I anticipate we have going today. If, in October, $10 billion worth of these mortgages are bought by GNMA, and if by September of next year they are resold, then the impact would be minimal or none.

But if they carried them over to another fiscal year based on Government accounting procedures, we would have a problem. But we do——

Mr. LaFalce. When we last used GNMA, what was the time frame between GNMA purchase and GNMA sale in the secondary market?

Mr. Schuyler. I think virtually all the single family mortgages were sold by 1976. They went marketed in 1974 and 1975. The multifamily mortgages take a longer period of time. Most of what we are talking about——

Mr. LaFalce. What percentage were single as opposed to multi?

Mr. Schuyler. I think it was about 60 percent to 70 percent single family at that time.

There have been a number of assumptions made by the Congressional Budget Office in computing what the cost of this program would be. But the budget authority costs would come close to that $10 billion, whatever figure is used.

I have one CBO estimate that has been done for Senator Weicker who has been working on this, where $5 billion were released in 1980 and $5 billion were released in 1981. The budget authority impact in 1980 would be slightly under $5 billion. The outlay impact in 1980 would actually be a gain of $80 million. That looks at a very short period of time for turnaround. In 1981 the outlays would go up. In 1982 you would again have an offset. So, the only way to look at a program is over a 4- or 5-year period for single and multifamily. The impacts in each year are going to go up and go down, based upon purchases and sales.

Mr. LAFALCE. If we do anything with Brooke-Cranston, we are not going to do anything until fiscal 1981, at the earliest. Are you trying to come up with some calculations, assuming that we implemented it? By the time we would pass that it will be toward the close of the Congress, in September or October, it would seem to me.

By the time it would be able to be implemented, it is going to be around the first of the year. Can you come up with some calculations based upon that?

Mr. SMITH. You are talking about fiscal year 1981?

Mr. LAFALCE. Yes.

There is no way to pass a budget this year unless it is in balance. How it is to be balanced is another question. And you favor that also as long as nothing is taken away from housing.

Mr. BANNISTER. Mr. Chairman, we think we have already taken a substantial share of the policy to deal with inflation.

Mr. LAFALCE. I agree with that fully.

Mr. SMITH. From 2-plus million in starts to less than 1 million starts in 2 years, with the existing demand we feel like we have done more than our share of the burden in this area. This is true for the home buyers as well.

Mr. LAFALCE. That is one of the reasons you are here. We have to recognize the fact that we have to have a special accommodation to the housing industry which in a time of recession and high inflation is one of the hardest hit of all the industries, at least insofar as the small business is concerned.

By the same token, if we are going to sell some program to alleviate your special plight, we must be able to make appropriate arguments, and we must have the money to support such a program.

So, if you could give this subcommittee your projections as to what the budgetary impact would be and your implementation under Brooke-Cranston with different authority—what is it you are pushing? Is it a differential of 1.5 percent?

Mr. BANNISTER. The way the bill has been reported out of the Senate Banking Committee, it would be at the discretion of the HUD Secretary at or below the FHA rates.

Mr. SMITH. Mr. Chairman. I believe Chairman Volcker had a very good statement when he said maintaining a certain level of activity in the housing industry is not inconsistent with an attack on inflation over time.

I think we should certainly keep this under consideration because the alternative here is that we are now approaching the collapse of an industry which would be mighty costly to reactivate.

I believe the Federal Reserve understands that problem. That is not inconsistent with our position.

Mr. LAFALCE. How many units would be started under reactivation of Brooke-Cranston per billion dollars?

Mr. **Smith.** I think we figured around 160,000 or 170,000, based on the full program and on $10 billion. If it were broken down to multifamily and single family factors, that could vary in units, depending upon the limitations of the mortgage.

Mr. **LaFalce.** Representative Carter?

Mr. **Carter.** Thank you Mr. Chairman.

We welcome you gentlemen today.

What determines the interest rate in our country and who determines it?

Mr. **Smith.** Since October 6, we have been quite concerned about that ourselves. We know what has happened to our industry since October 6.

Mr. **Carter.** Where are you from?

Mr. **Smith.** Fort Worth, Tex.

Mr. **Carter.** That is what I thought.

You had a distinguished gentleman from Texas by the name of Wright Patman. Years ago he told us—and we found it to be quite true—that the interest rate is what the Federal Reserve Chairman says it is.

As you know, for less frequent borrowers, the Federal Reserve lends at 13 percent, or discount rates. For frequent borrowers it is up to 16 percent. It is in his hands. He makes this determination.

This is why the interest rate is up so high. I guess he is a good man. He comes from New York City. Evidently he believes in the brotherhood of man and the fatherhood of God and the neighborhood of New York at about 30-percent interest. It looks that way.

But I am telling you right now that it is wrecking this country. I have never had as many complaints. I have never seen as many people who are troubled.

For that reason, I introduced a usury law a few days ago. If the Congress has the grit enough to do it, we can bring that down. I, for one, want to do it because I want to see this $9 billion worth of homes—which you say you have—sold and occupied.

Mr. **Smith.** Yes, sir, and the market is there to do it at a reasonable interest rate.

Mr. **Carter.** At a reasonable interest rate.

It just staggers the imagination to see the interest rate that we have. I believe you state that the average loan out at the present time is 16 percent; is that correct?

Mr. **Smith.** Close to it, yes, sir. We are looking at 20 percent, 21 percent, and 22 percent on construction loans on the average.

Mr. **Carter.** Construction loans on houses now are 20 percent?

Mr. **Smith.** Yes; that has added over $1,000 to the average cost of a house in the last few months.

Mr. **Carter.** You have to add it on to the cost. I believe you stated he might get his loan at 16 percent. But I rather doubt that.

Mr. **Smith.** It is 17 percent or 18 percent in some areas.

Mr. **Carter.** A friend of mine borrowed some money a while back to pay his income taxes. He paid 17 percent for that. He is supposed to be a good customer of that particular bank.

The average cost of a home in this country is how much?

Mr. **Smith.** It is $64,000 to $65,000.

Mr. **Carter.** At 16 percent, then the payments would be $9,600 a year, or $800 a month; is that correct?

Mr. **Smith.** We have in our testimony that, yes sir.

Mr. **Carter.** That is $800 per month. I believe you state that they—that is, the total payment on what they owed be $807, which would be $7 on the principal.

At that rate, how long would it take them, then, to pay this entire amount?

Mr. **Smith.** Well, the $807 is based on a 30-year, straight line amortization.

Mr. **Carter.** We hope the $800 would go down.

Of course, GNMA bonds are being done at the present time. They bear an interest rate of how much; do you know?

Mr. **Smith.** They were off slightly.

Mr. **Carter.** It was about 22 percent the last time I saw it, or a little better.

Mr. **Smith.** I do not know.

Mr. **Carter.** However, they do not have full faith and credit of the Federal Government; do they?

Mr. **Smith.** GNMA?

Mr. **Carter.** Yes.

Mr. **Smith.** I will not argue that issue.

Mr. **Carter.** It is my understanding. I am not sure I am right.

What would solve your problem? Bringing the interest rate down?

Mr. **Smith.** That would be one of the best things that could happen to our industry.

Mr. **Carter.** I noticed a loan was made to Anisept Airways from the Eximbank of $290 million to Mr. Murdoch, the publisher of the New York Post, at something like 8 percent or 9 percent.

Do you think that Mr. Murdoch, an Australian, should be treated better than you are treated in this country?

Mr. **Smith.** I believe the buyer of a new home should get as good an interest rate as an Australian doing business in this country; yes, sir.

Mr. **Carter.** Do you think he should get a better rate since he is a citizen of this country?

Mr. **Smith.** I would not argue that.

Mr. **Carter.** I would argue that all day. My people deserve better. The idea of lending money at a low rate of interest when we are paying a minimum of 16 percent to 20 percent for housing, at 8 percent or a little above for $290 million?

That staggers the imagination. I think this country has got to turn around. We have to help you people. I want you to build that home for the young couples of our country. We want them to have a chance to pay for it.

But at a minimum rate of 16 percent they just cannot do it, as I see it.

I see bankruptcies not only in your area. There are car dealers and small businessmen and farmers in Iowa who are going bankrupt. Iowa is one of the richest, most fertile States in the Union. Farmers state they cannot do it this year because of the highest interest rates.

We are talking about a recession or a depression. It did not begin yesterday. It began before that. As I see it, we are in it right now. I think it is time to do something about it.

Thank you, Mr. Chairman.

Mr. **Smith.** I might add that on the medium priced house that we discussed earlier, less than 5 percent of the couples today can qualify for the loan. They would have to have an income of $49,056 a year.

Mr. LaFalce. Mr. Smith, I want to thank you very much for your testimony. I look forward to receiving additional information.

Mr. Smith. I will get it to you. I appreciate the opportunity.

Mr. LaFalce. At this time I would like to call the National Federation of Independent Business represented by Mr. Edison Zayas, economist.

Mr. Zayas, you may proceed.

TESTIMONY OF EDISON R. ZAYAS, ECONOMIST, NATIONAL FEDERATION OF INDEPENDENT BUSINESS; ACCOMPANIED BY ABE SCHNEIER, TAX CONSULTANT, RESEARCH DEPARTMENT

Mr. Zayas. Thank you, Mr. Chairman.

I am Edison Zayas, economist, National Federation of Independent Business.

I would like to ask that my prepared testimony, in its entirety, be inserted in the record.

Mr. LaFalce. Without objection, so ordered.

[Mr. Zayas' prepared statement follows:]

Prepared Statement of Edison R. Zayas, Economist, National Federation of Independent Business

Mr. Chairman, I am Edison Zayas, Economist on the Research Department Staff of the National Federation of Independent Business (NFIB). On behalf of NFIB and its 600,000 small member firms, I am grateful to have this opportunity to place in perspective the meaning of inflation to small businesses.

Although small businesses are faced with a multitude of problems, none affects them more adversely than spiraling and volatile rates of inflation. Since the first quarter of 1974, one quarter after NFIB began its Quarterly Economic Report, our members have consistently ranked coping with inflation as being their single most important problem (see Table 1). Despite today's record-high rates of interest, NFIB members continue to rank inflation as their most important problem (see Table 2). Our purpose in being here today is not to ask for special favors that might help small business cope with inflation, but to stress how vital restoring price stability is to the future of small business.

INFLATION AND THE INHERENT CHARACTERISTICS OF SMALL BUSINESS

Most segments of society are impacted adversely by inflation. However, not everyone is affected equally by periods of prolonged price instability. Generally speaking, the poor, the elderly, and the middle-income earners who are typically not financially diversified, face greater difficulties in maintaining their living standards during inflationary periods. For similar reasons, small businesses also face disproportionate hardships in coping with inflation.

Small businesses have great difficulties operating in an inflationary environment because of the general nature of small businesses and the markets they operate in. They have little control over the costs of their inputs, and are forced to accept the ever-rising costs of their supplies. At the same time, they have little control over the prices they charge on the sale of their goods and services. This places small firms in the precarious situation of either passing on the higher costs of their supplies to the consumer and risk pricing themselves out of a competitive position, or of absorbing the price increases in order to remain competitive with larger firms. This inability to fully pass on costs is not shared by larger firms who can and do pass on their costs. For example, when was the last time General Motors accepted reduced profit margins in order to maintain lower prices?

As a practical matter then, these characteristics shared by most small businesses have placed smaller firms at a competitive disadvantage during these currently inflationary items. Aside from this general perspective, we can be more precise in showing how inflation affects a small business in the course of its daily operations.

INFLATION AND SMALL BUSINESS OPERATIONS

Inflation, Inventory and Small Business

Although inflationary periods escalate inventory costs to all businesses, small businesses are affected in a manner that threatens their profitability and their existence. The need to replace inventories at ever higher prices severely restricts a small businesses cash flow and its ability to finance inventories from internally generated funds. The costs of purchasing goods for inventory is as much an investment as the purchase of plant and equipment, and is considerably more frequent. The constantly rising replacement costs of inventories increases the investment funds needed, while the cash flow and net profits actually lag behind at increasing rates. As this process unfolds, the cash flow dwindles to the point that small businesses are ultimately forced to borrow funds in order to purchase inventories (see Table 3).

Borrowing is a significantly more expensive manner in which to finance inventories which in turn depresses profit margins even more. This self-perpetuating process of increasing costs is particularly damaging to small business since they have great difficulties in passing on those costs.

At the same time, escalating inventory costs are further damaging to small firms in that it increases their tax liability which will be discussed subsequently.

To the extent that inflation diverts investment funds from expansion and modernization purposes to financing inventories and general business operations, inflation acts as a drag on potential productivity gains among small businesses. Instead of investing resources to create more wealth, the entrepreneur must invest his resources in remaining solvent. As a result, no net increase in real wealth accrues. This contention is consistent with the marked drop in marginal capital productivity among proprietorships in the period 1970–1975, a time characterized by increasing inflationary pressures (see Table 4).[1]

Approximately one of every two small businesses is substantially impacted by the inventory problem. Principal among these are retailers, wholesalers, and manufacturers.

"For some years now we have been taking in more and more money, but all we are doing is handling more, not making more; in fact not making as much."

NORTH GRAFTON, MASS.

"Last year I had a 32 percent increase in dollar volume and my bottom line figure netted 10 percent less profit than the year before."

MOGADOR, OHIO.

"Our costs of purchasing equipment are now so high that we cannot adequately raise our rates enough to cover the increase: to keep cash flow at adequate levels we are decreasing inventory significantly and selling large, costly equipment!"

ROCKVILLE, MD.

"In comparing the last three month period to the same three month period last year finds the sales $ volume up and the profit $ down, which goes back a great deal to the problem of inflation."

FORT WORTH, TEX.

"At the rate the companies are raising their prices, at least every 3 months, there is no way we can keep up. . . ."

MODESTO, CALIF.

"If inflation doesn't slow down, we will all be in trouble. It is going up so fast that it is a real problem to keep items in the store priced right."

WAURIKA, OKLA.

Inflation, Credit and Small Business

Since 50 percent of small businesses have been borrowing on a regular basis, (defined as borrowing at least once a quarter), interest costs are an integral part of many small businesses total operating cost. During periods of extreme price instability, nominal interest rates on loans also rise as lenders attempt to protect the value of their future income streams over the life of a loan. Rational people simply can't lend money at a loss. As in the case of inflated inventories, inflated interest costs place a heavy drain on a small business' cash flow. In the many instances where lenders underestimate expected rates of inflation, small businesses do pay back those loans in cheaper dollars. However, as inflationary premiums are attached to interest rates, it becomes harder for small businesses to service their debt as rising rates eat into their cast flow. This assertion is supported by the fact that during inflationary periods, "interest rates and financing" moves up in rank among NFIB members as being their single most important problem (see Tables 1 and 2).

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[1] Stahrl W. Edmunds, "The Capital Productivity of Proprietary vs. Corporate Business", Dean, Graduate School of Administration and Professor of Administration and Economics, University of California, Riverside.

As mentioned earlier, escalating inventory replacement costs force small businesses to borrow more often in order to finance those inventories as their cash flow diminishes. Escalating labor costs have the same effect. The result is that small businesses are forced to borrow in greater amounts to finance business operations, but in addition, they must also pay for those increased costs at inflated rates of interest. This simply translates into another wave of increased costs to the small business, which must either be absorbed or passed on to the consumer in the form of higher prices. Again, the latter course of action is more difficult for smaller firms than it is for larger firms due to the highly competitive nature of the markets most small businesses operate in.

Inflation has an equally adverse effect on the interest rates charged on consumer finance loans. Final sales in the construction and auto retail industries, which are composed primarily of small businesses, depend almost exclusively on the price and availability of consumer credit due to the "big ticket" nature of their high rates of inflation lead to inflated rates on consumer loans. As nominal rates of interest reach prohibitively high levels, consumers are forced to respective sales. As in the case of business loans, periods of persistently high rates of interest reach prohibitively high levels, consumers are forced to postpone their buying plans until inflationary pressures ease and interest rates fall. This is the current state of affairs in both the housing and auto retail industries where aggregate demand has fallen precipitously and shows no sign of improvement till inflation and interest rates head downward. Housing starts in February were running at an annual rate of 1.3 million units, the lowest since December of 1975, and auto sales were 11% below year-ago levels in mid-March.[2] Unless inflation is brought down in a hurry, interest rates will remain at lofty levels and scores of construction firms and auto dealers will be forced to go out of business. As it is, approximately 600 auto dealers went out of business in 1979, four times the 1978 level. In the first two months of 1980, 200 more car and truck dealers had to close shop.[3]

Finally, many small businesses extend credit to their customers. This phenomenon is more characteristic of rural and old urban neighborhoods, than suburban areas. The typical result is that accounts receivable are of longer duration than accounts payable. In an inflationary environment, and particularly during an economic downturn, the small business becomes stretched like a rubberband. Large suppliers want their money, but customers repay more slowly and do so in dollars of declining value.

In short, inflation ultimately limits the ability of a small business to effectively finance its operations, while depressing consumer demand for its products. The final outcome—severe profit squeezes and eventual bankruptcy (see Addendum).

Inflation, Taxation and Small Business

While inflation is simultaneously constraining the ability of small businesses to finance their internal operations and is depressing demand for their products, inflation also distorts a small business' tax liability. To be sure, inflation increases the tax liability of all businesses. However, larger businesses due to their wide array of available financial and human resources, are better able to minimize their tax liability.

Over 50 percent of small business employers are partnerships and proprietorships who pay taxes as individuals.[4] Inflation tends to push individuals into higher income tax brackets under a progressive income tax system, unless there is an upward adjustment of the tax brackets to offset inflation. These nonlegislated increases in taxes reduce retained earnings among small firms at a time when they desperately need internal sources of funds. Larger firms, which are typically corporations, have a similar problem, only the relative impact is minimized by the existence of a maximum corporate tax rate of 46 percent on earnings above $100,000. Moreover, larger firms can more easily utilize the LIFO system of inventory accounting which helps reduce their tax liability during inflationary periods.

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[2] "Outlook for Year Ahead, Sliding Into a Slump—and Up Again in 1981", *U.S. News and World Report*, April 14, 1980, p. 24.

[3] "Tight Credit Slams Car Dealers Two Ways", *Business Week*, April 14, 1980, pp. 29–30.

[4] NFIB *Quarterly Economic Report for Small Business*, January 1980.

In, 1974, for example, $7 billion in individual income taxes was overpaid to the Treasury because of inflation, and the overpayment fell most heavily on the middle income brackets. Sixty-six percent of the overpayment was made by people earning between $10,000 to $50,000 in adjusted gross annual income, while 31 percent was paid by those with $20,000 to $50,000 in adjusted gross annual income.[5] These income groups that bear the brunt of inflation induced tax overpayments, coincide with the primary income groups of most small business owners. According to an NFIB *Employment Report for Small Business*, 74 percent of business owners earned between $10,000 and $50,000 in 1977. (More owners earned less than $10,000 than over $50,000.)[6] Consequently, large numbers of small business owners must pay higher taxes at a time when they are most vulnerable.

To make matters worse, small businesses tend to be labor-intensive in nature and therefore pay a relatively high proportion of payroll taxes. During periods of prolonged inflation, an employer's total payroll will tend to increase faster than otherwise and payroll taxes obviously follow the same path. Small business owners consider payroll taxes to be their costliest tax, so inflation-induced rises in those taxes make life that much more difficult for the beleaguered small business owner (see Table 5).

Inflation, Uncertainty and Small Business

By now it should be clear that the adverse effects of inflation on small businesses tend to "snowball" and become self-feeding. As this occurs, a more fundamental problem is created for small business owners, that being the element of uncertainty. At the risk of being repetitive, this problem is also shared by businesses of all sizes, but again, dealing with this problem is more difficult for the small business with limited financial and human resources.

Operating a small business during periods of highly volatile rates of inflation, becomes much more complex as it gets harder to make current decisions based on information about future conditions, which are increasingly unpredictable. Unlike larger businesses, small businesses do not benefit from the presence of specialized advisors who can keep their abreast of volatile market conditions and advise them on how they should respond to them. At the same time, small businesses do not have the financial cushion to protect them from costly mistakes which become more probable during periods of price instability. For instance, a small business who must bid for contracts, has to make those bids predicated on a set of perceived costs. If those costs are constantly changing, it becomes difficult for a small business owner to know what to bid without underestimating his/her costs. A larger and more diversified firm may be able to offset losses on a contract with returns from other operations, a scenario which is atypical with most small businesses.

The problem of uncertainty cannot be underestimated and is best demonstrated by some of our membership comments:

"How can anyone make any commitments for the next six months with the economic insecurities that exist and the uncertainty to come."

MOUNT DORA, FLA.

"With the loss of sales, the rising costs and interest rates, I am uncertain as to whether I should expand my business."

WHITEHALL, PA.

"I am very uncertain about the future in so far as transportation costs, equipment costs, and inventory costs are going up at increased proportions to make planning for the future infeasible. Also current loan interest rates are prohibitive for expansion.

FREDERICKTOWN, OHIO.

"I feel that present economic conditions do not justify new equipment or expansion. The future appears too unstable and risky."

KNOXVILLE, ILL.

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[5] Dr. John H. Moore, "Inflation and the Burden of Taxation", *NFIB Public Policy Discussion Series*, 1979.

[6] NFIB *Employment Report for Small Business*, 1977.

"Increases in gross purchasing of inventory are leaping ahead almost on a bimonthly basis. In some instances we cannot keep up with repricing merchandise. Future quotation on materials and supplies are out of the question.

BALTIMORE, MD.

"Rampant inflation is wreaking havoc with the prices of our products."

PETOSKEY, MICH.

"Our prices must be published 6–8 months in advance. This has been our single largest problem. We cannot put a price on our service so far in advance because of the ridiculous rate of inflation."

NEW ROCHELLE, N.Y.

In sum, the uncertainty created by rampant inflation greatly intensifies the difficulties faced by small business owners. Under these circumstances, excessive attention must be paid to guessing future price developments, thereby diverting management efforts from more productive endeavors.

Inflation, Competition and Small Business

To say that inflation places small businesses at a competitive disadvantage is to say the obvious. Nevertheless, it is worth emphasizing and restating.

The uncertainty created by inflation combined with the inability of smaller firms to fully pass on their costs make them more vulnerable to the competitive pressures of the market place. As inflation continues to erode the purchasing power of the dollar and distort the continuity and efficient functioning of resource markets, small businesses will increasingly find themselves incapable of competing with larger more diversified firms. To allow inflation to continue unabated will clearly lead to a steady increase in small business failures and contribute to growing aggregate market concentration.

Small Business and Restrictive Monetary Policy

When the Federal government runs consistently enormous budget deficits, those deficits can be paid in one of two ways: borrowing or monetizing them. If we pay for them by borrowing, someone in the private sector who wants credit is "crowded out". Small business is among the first. On the other hand, if we monetize the debt, inflation follows. Over a period of inflation small business suffers more than most. When we decide to take the cure for inflation by reducing the rate of monetary growth, small business is among the first to be hurt. And some people wonder why small business has been so upset by the tacit fiscal policy this nation has pursued over the past fifteen years.

Following the shake out of 1974–75, we should have learned. Unfortunately, fighting inflation again becomes a matter of rhetoric and symbols. Our government refused to put its house in order and small business is being severely injured again. We find ourselves in the typical "no win" position. If inflation is allowed to run unabated, small business loses; if this nation takes the cure, small business loses. It simply places us in a situation of determining whether the long term illness is worse than the short term cure, and it is. But having been burned once, we are enormously concerned that after we take the cure, the Federal government will again proceed on its merry way until the same set of problems face us requiring the cure for a third time.

In our view, an integral part of any anti-inflationary policy is prudent monetary policy. A prudent monetary policy reduces the rate of growth in the money supply. So long as the Federal Reserve maintains a stable and reduced rate of growth, and so long as the Federal Reserve gets help from other parts of the government, nominal interest rates will drop as will inflation.

Without a doubt, the short-term effects of this transition in monetary policy are to dramatically raise the cost and limit the availability of credit to small business. Many small businesses are facing extremely hard times as they attempt to obtain costly credit to finance growing inventories. To the extent that small firms are being rationed out of the debt market, we may actually observe a large increase in the number of small business failures. According to a study conducted by William L. Silber and Murray E. Polakoff, commercial banks do ration small businesses out of their commercial loan portfolios during periods of restrictive monetary policy. Using data collected by the Federal Reserve System in 1955 and 1957, which is the only set of data giving a breakdown of commercial and industrial loans by size of borrower, Silber and Polakoff demonstrated that during tight money periods banks wished to favor large business by raising the portion of funds available for large business loans, while reducing the amounts earmarked for small business loans. Given these different lending propensities during these periods, they were able to show that the desire to ration small business loans actually resulted in the rationing of those loans. Thus, the lack of alternative debt-financing sources ostensibly is a major problem to small businesses during tight money periods. While large businesses can turn to the Eurodollar, commercial paper, and equity markets, small firms simply have no viable alternatives during these periods. As seen in Table 6, during the last cyclical downswing, non-farm, non-corporate businesses (which are primarily small businesses) began to experience a decrease in the amount of funds raised in the credit markets as early as 1973, and this trend carried on through 1975. Corporate businesses (comprised mostly of larger firms), on the other hand, were able to obtain funds in increasing amounts through 1974. Most of the funds obtained by the latter came from new issues of stocks and bonds, an alternative not available to small business.

It is this lack of alternative sources of financing that makes restrictive monetary policies so onerous to small firms. Therefore, we must ask why small businesses are so limited in their financing alternatives.

In our view, the principal reason for this is a complete lack of demand for the small business loan market. At this moment, the commercial banking industry has a virtual monopoly over the small business loan market and are under no competitive pressures to be more aggressive in servicing small businesses. Augmenting this problem, is the overly conservative attitude of bank loan officers which results primarily from the historical emphasis of bank regulators on bank safety and solvency rather than bank performance. Although we do not advocate lending to concerns that are clearly not credit worthy, we feel that there is great room for more aggressive commercial lending, especially in light of the well established and tested federal deposit insurance fund.

As in most instances, increased competition in the commercial loan market would ensure a wider array of financing alternatives for small businesses at more competitive rates. More competition for the small business loan market would force lenders to pay closer attention to the specific needs of small business, thereby allowing them to develop financing packages that are better suited to the nature of small business operations. The complete lack of regard given to small business by most regional and money center banks is reflected in the fact that few of them have specialized small business lending departments with loan officers who understand a small business needs. Until more competition is fostered for small business lending, small businesses will continue to bear the brunt of restrictive monetary policies. There is a desperate need for new innovative techniques in the financing of small businesses. In the market for large business loans where competition is intense, financing packages have become increasingly sophisticated and tailored to the individual client's business operations. On the other hand, there has been little change in the way small businesses have been financed in the last twenty years.

Thus, in order to spread the burden of restrictive monetary policy more evenly among all businesses, a greater number of lending institutions should be given authority to extend commercial loans, especially to small businesses. At the same time, commercial bank regulators should encourage more aggressive small business lending by striking a more reasonable balance between bank lending performance and bank safety and solvency.

SMALL BUSINESS AND THE SPECIAL CREDIT RESTRAINT PROGRAM

(NFIB is currently polling its members on the special credit restraint program. We, therefore, have no position on the program at this time. The following is a staff analysis of the situation.)

The program which seeks to slow credit growth by making the extension of consumer loans more costly to lenders and by limiting total loan growth to a narrower growth range, comes at a time when the economy appears to be slowing. When controls were announced, consumer installment credit growth was on the way down. Essentially, the problem appears to be self-correcting.

The Special Credit Restraint Program has some potential problems for small businesses. In the first place, if the controls on consumer borrowing are effective in reducing aggregate demand at the retail level, it will augment the sales decline that is already taking place. This in turn, would create a larger and perhaps more rapid increase in involuntary inventory accumulation. That, of course, would force small businesses to borrow greater amounts of costly funds from commercial banks in order to finance the inventory build-ups. At the same time, the Federal Reserve Board's request that total annual loan growth be limited to a 6 percent to 9 percent range, would squeeze small businesses out of the loan market at a time when they are being effectively forced by the government to borrow more to finance growing inventories. Although the Federal Reserve Board has exempted small business and agricultural loans from the requested loan limitation, history shows that commercial banks tend to ration small business out of the loan market during periods of tight money.[7] Moreover, as a practical matter it is unrealistic for the bank regulators to expect banks to voluntarily continue lending to small businesses when they are limited in what they can lend to the larger firms whose loans are more profitable. Given that interest rate spreads are becoming narrower and narrower, it is more realistic to expect bankers to first serve their larger clients and loan the remainingn funds to small business on a first-come-first serve basis. Unfortunately, we have no numerical evidence that this is in fact happening at the moment. However, based on the increasing number of NFIB membership letters we are receiving, we feel confident that many small businesses are currently being displaced from the market.

SUGGESTED POLICY ACTIONS

Inflation can only be reduced by following more responsible fiscal and monetary policies, by eliminating excessive and costly government regulations, by handling our energy problem, and by eliminating structural disincentives to increased production.

The elimination of inflation would benefit small business and the entire country more than any other accomplishment. We recognize that reaching that goal will take years of persistence and courage in the face of mounting political pressures. There are no simple solutions to the inflation problem, and there is no avoiding the painful short-term effects associated with long-term anti-inflationary policies.

Small business is willing to share these burdens in order to attain our primary national goal. However, efforts should be made to spread the burden more evenly. We urge that closer attention be paid to the competitive structure of our financial industries in order to increase competition for the small business loan market. If the burden of inflation and anti-inflation policies is to be borne more evenly across our economy, it is imperative that a greater number of alternative sources of financing be made available to small business. We urge that this Congress encourage development of new innovative techniques that will better meet the financial needs of small business. The past years of persistent inflation have exposed the shortcomings of our financial system in meeting small business' needs. While we must never abandon policies to reduce inflation, we must never abandon efforts to improve the responsiveness of our financial system to all segments of the economy.

The Federal Reserve Board should be encouraged to collect bank loan data by size of borrowing firm to allow the observation of small business loan growth patterns. The collection of such data would also permit more adequate enforcement of the Community Reinvestment Act as it pertains to the needs of local small businesses.

In addition, NIFB is currently assessing the feasibility of a proposal called the Loan Loss Reserve Program (LLRP), which is designed to enable banks to substantially increase their capacity to make aggressive, slightly risky small business loans in a format requiring almost no government bureaucracy. The program is based on developing specific loss reserve funds to cover potential losses from a portfolio of small business loans, with each bank having its own loss reserve fund. Contributions to the loss reserve fund would be made at the time each loan is made. Equal contributions would be made by both the bank and the business and both contributions would be matched by the federal government. Although we have yet to work out all of the details of the proposal, we are encouraged by the innovative nature of the program and we will continue to give it serious attention.[8]

Although proposals such as the Loan Loss Reserve Program are highly important in themselves, it is the fresh new approach of such programs that encourages us, and we will continue to promote similar ideas.

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[7] Silber and Polakoff, "The Differential Effects of Tight Money: An Econometric Study", *The Journal of Finance*.

[8] Derek Hansen and Associates, Inc., "The Loan Loss Reserve Program", Proposal prepared for the National Federation of Independent Business, October, 1979.

TABLE 1.—SINGLE MOST IMPORTANT SMALL BUSINESS PROBLEM, 1974–78

Most important problem	1974								1975								1976								1977								1978							
	Jan.		April		July		Oct.		Jan.		April		July		Oct.		Jan.		April		July		Oct.		Jan.		April		July		Oct.		Jan.		April		July		Oct.	
	R[1]	%	R	%	R	%	R	%	R	%	R	%	R	%	R	%	R	%	R	%	R	%	R	%	R	%	R	%	R	%	R	%	R	%	R	%	R	%	R	%
Taxes	3	10	3	10	3	10	3	8	3	11	2	18	2	19	2	16	2	17	2	21	2	22	2	20	2	21	2	21	2	19	2	21	2	22	2	20	2	21	2	18
Inflation	2	23	1	19	1	36	1	41	1	37	1	28	1	27	1	29	1	28	1	25	1	25	1	24	1	24	1	28	1	27	1	25	1	25	1	32	1	33	1	34
Inadequate demand for product[2]	9	2	9	1	9	1	9	1	9	1	5	8	6	6	6	6	8	5	8	4	8	3	8	5	8	4	8	3	7	5	8	4	8	3	8	2	8	2	8	4
Interest rates, financing	5	8	7	6	2	12	2	16	2	13	3	10	4	8	4	10	5	8	5	6	5	7	5	7	7	5	7	5	8	4	7	5	7	5	7	5	5	7	6	7
Minimum wage laws, cost of labor	8	3	8	5	8	4	8	2	7	4	7	5	8	5	7	5	6	6	5	6	6	6	5	7	5	7	6	6	5	8	4	9	4	8	6	7	5	7	6	7
Other Government regulations, red tape	5	8	6	8	5	8	5	6	4	9	3	10	3	12	3	12	3	13	3	16	3	14	5	7	3	12	3	12	3	12	3	11	3	12	3	11	3	10	3	10
Competition from large business	5	8	3	10	5	8	5	6	5	8	5	8	4	8	5	8	4	10	4	9	4	9	3	13	4	10	4	9	4	9	6	8	4	8	4	8	7	6	4	8
Quality of labor	3	10	3	10	5	8	4	7	6	5	7	5	6	6	6	6	6	6	7	5	7	5	4	10	6	6	5	7	6	7	4	9	6	7	4	8	4	8	4	8
Shortage of fuels, materials, or goods	1	23	2	15	4	9	5	6	7	4	9	2	9	2	8	1	9	1	9	1	9	1	9	(3)	9	2	9	1	9	1	9	1	9	1	9	1	9	1	9	1
Other, no answer		5	----	5	----	4	----	7	----	8	----	6	----	7	----	7	----	6	----	7	----	8	----	7	----	9	----	8	----	8	----	7	----	8	----	5	----	5	----	5
Total		100	----	100	----	100	----	100	----	100	----	100	----	100	----	100	----	100	----	100	----	100	----	100	----	100	----	100	----	100	----	100	----	100	----	100	----	100	----	100

[1] Rank.

[2] This topic was first used in April 1975 survey questionnaire; data shown for previous surveys is in response to labor unions, which was deleted from the April 1975 survey questionnaire.

[3] Less than 0.5 percent.

Source: Quarterly Economic Report for Small Business, National Federation of Independent Business, various editions.

TABLE 2.—QUESTION: WHAT IS THE SINGLE MOST IMPORTANT PROBLEM FACING YOUR BUSINESS TODAY?

Most important problem	1978				1979								1980	
	July		October		January		April		July		October		January	
	Rank	Percent	Rank	Percent	Rank	Percent	Rank	Percent	Rank	Percent	Rank	Percent	Rank	Percent
Taxes	2	21	2	18	2	15	2	16	2	15	2	14	3	15
Inflation	1	33	1	34	1	36	1	36	1	39	1	37	1	35
Inadequate demand for product	8	2	7	2	8	2	8	2	9	2	8	2	7	3
Interest rates and financing	5	7	6	7	3	11	3	10	3	9	3	13	2	16
Minimum wage laws, cost of labor	5	7	6	7	5	7	6	6	6	5	7	5	6	4
Other government regulations, red tape	3	10	3	10	4	9	4	8	3	9	5	7	4	8
Competition from large business	7	7	4	8	5	7	6	6	6	5	5	6	5	5
Quality of labor	4	8	4	8	5	7	4	8	5	6	4	8	5	5
Shortage of fuels, materials or goods	9	1	8	1	9	1	7	3	6	5	8	2	7	3
Other, no answer		5		5		5		5		5		6		6
Total		100		100		100		100		100		100		100

TABLE 3.—EXAMPLE OF SMALL BUSINESS CASH FLOW IN ZERO INFLATION AND HIGH INFLATION ERA

Transaction	Zero inflation [1]				High inflation [2]			
	Transaction costs	Cash before taxes	Cash after taxes	Cumulative taxes	Transaction costs	Cash before taxes	Cash after taxes	Cumulative taxes
Original investment		$105.00				$105.00		
1st inventory:								
Purchase price	$100				$100			
Sales price	110				110			
Net profit	10				10			
Amount		115.00	$112.50	$2.50		115.00	$112.50	$2.50
2d inventory:								
Purchase price	100				110			
Sales price	110				121			
Net profit	10				11			
Amount		122.50	120.00	5.00		123.50	[3] 120.75	5.75
3d inventory:								
Purchase price	100				[3] 121			
Sales price	110							
Net profit	10							
Amount		130.00	127.50	7.50				
4th inventory:								
Purchase price	100							
Sales price	110							
Net profit	10							
Amount		137.50	135.00	10.00				

[1] Assumes 25-percent tax rate and a 10-percent markup.
[2] Assumes 25-percent tax rate, 10-percent inflation, and a 10-percent markup.
[3] Go to the bank.

TABLE 4.—CAPITAL PRODUCTIVITY OF PROPRIETARY VERSUS CORPORATE BUSINESS, 1949–75

[In constant 1972 dollars of sector income per dollar of net capital stock]

Period	Average capital productivity		Marginal capital productivity	
	Proprietary	Corporate	Proprietary	Corporate
1949–53	1.34	0.92	0.37	1.05
1954–60	1.12	.90	.30	.19
1961–69	.92	.96	.40	.84
1970–75	.75	.86	.01	.15

Source: Taken from, "The Capital Productivity vs. Corporate Business," by Stahrl Edmunds, Dean Graduate School of Administration, University of California, Riverside.

TABLE 5.—COSTLIEST BUSINESS TAX FOR SMALL BUSINESS, 1977

[In percent]

Form of business	Type of tax Payroll[1]	Business income[2][3]	Inventory other	Other	Undecided
Proprietorship	43	37	16	2	7
Partnership	46	32	16	2	4
Corporation	61	27	7	1	4
Annual gross receipts (in thousands):					
Less than $50	31	42	21	2	3
$50 to $99	44	34	17	2	3
$100 to $199	50	31	14	2	4
$200 to $349	58	28	9	1	4
$350 to $499	61	26	9	1	3
$500 to $749	62	28	6	1	3
$750 to $999	60	26	8	2	5
$1,000 to $2,999	60	32	5	----------	3
$3,000 and above	46	41	6	2	6
Sector:					
Retail	50	31	14	1	4
Wholesale	49	36	8	1	6
Manufacturing	32	57	8	2	2
Construction	66	27	4	1	2
Nonprofessional services	53	32	11	2	3
Finance	62	28	4	1	5
Transportation	65	22	26	2	6
Professional services	44	40	12	1	3
Agriculture	32	34	33	1	1
Unclassified	35	41	11	8	5
Total	52	32	12	1	4

[1] Includes any payroll tax, e.g., social security and unemployment compensation.

[2] Includes State and local income taxes where applicable.

[3] Personal income tax for proprietors and partners; corporate income tax for corporations.

Source: Unpublished tabulations, National Federation of Independent Business, 1978.

TABLE 6.—FUNDS RAISED IN U.S. CREDIT MARKETS BY NONFINANCIAL SECTORS, 1972–77

[In billions of dollars]

Nonfinancial sector	1972	1973	1974	1975	1976	1977
Governments:						
Federal	15.1	8.3	11.8	85.4	69.0	56.8
State and local	14.5	13.2	15.5	13.2	18.5	25.9
Businesses:						
Farm	5.8	9.7	7.9	8.7	11.0	14.7
Nonfarm noncorporate	14.1	12.8	7.4	2.0	5.2	12.6
Corporate	58.3	72.7	81.8	37.0	58.2	78.7
Households	63.4	80.9	49.2	48.6	89.9	139.6

Source: Flow of Funds Accounts, Federal Reserve System, May 1978.

Mr. ZAYAS. I am accompanied by Mr. Abe Schneier, tax consultant in our research department.

On behalf of NFIB and its 600,000 small business firms, I would like to express our appreciation for giving us an opportunity to place a prospective on the high rate of inflation on small businesses in this country.

Before I get started, I would like to read a letter sent by one of our members which I think depicts better than our 16-page written statement the problems that are faced by small businesses in periods of high inflation.

It says:

ADDENDUM

CERES LITHO,
Mountain View, Calif., March 26, 1980.

NATIONAL FEDERATION OF INDEPENDENT BUSINESS INC.,
150 W. 20th Avenue, San Mateo, Calif.

GENTLEMEN: I want to share with you the hurt I am feeling. It's a pain I have never experienced. As President of this small Company, I have been forced to lay off three good employees. These people had done nothing wrong, they were outstanding in every way. I had to do it! The prime is out of sight, vendors are squeezing down on credit, I had to cut cost and it was the only way for us.

Please, I beg you, continue to work towards getting Government out of the private sector. Big Government is the major cause of inflation. They have lost an understanding of the value of small business to our economy. I feel like an animal! These people had done nothing to deserve being laid off; it was our final chance at survival. I'm just sick at heart.

Sincerely,

FRANK P. SISTI, *President.*

I think that Mr. Ceres situation is highly representative of the circumstances small businesses are finding themselves in. Generally speaking, inflation is particularly dangerous to small business because it ultimately reduces their profit margins to the point that it is no longer possible to survive.

This occurs because small businesses are, on the whole, price takers. This means they have no control over the ever-rising cost of their supplies and at the same time they have extreme difficulty in passing on those costs because of the highly competitive nature of the markets they operate in.

Consequently, as inflation runs rampant, small businesses are faced with increasingly smaller profit margins.

More specifically, however, as small businesses are faced with increasingly more expensive inventories, their cash flow dwindles to the point that it becomes necessary to borrow to finance those inventories.

In inflationary times, however, the cost of credit is also inflated as lenders seek to protect the value of their investments. Consequently, small businesses must not only pay for more expensive inventories, but also must pay for those inventories with inflated credit.

The net result is a fulther increase in a small business' operating costs which leads to a further reduction in the profit margins.

On the other side of the coin, inflation also raises interest rates on consumer credit, which eventually depresses aggregate demand and thereby reducing sales and leading to a further involuntary buildup of costly inventories.

If distortions created by inflation stopped here it would be bad enough. Only there is more. During inflationary periods, a small business' tax liability is also increased. Keep in mind that over half of the small businesses are partnerships and proprietorships who pay taxes as individuals.

As inflation pushes small business owners into higher tax brackets, it simply adds another drain on the retained earnings. This, in turn, has the added effect of further reducing the cash flow and forcing them to borrow again at inflated rates.

There is still more. Small businesses are, by and large, labor intensive and, therefore, pay a relatively high proportion of payroll taxes. As payrolls rise to keep up with inflation, payroll taxes also increase, leading to an even further erosion of the small business' retained earnings.

All of these cascading effects put together paint a very grim picture for the outlook of small businesses.

In addition to these inflationary-induced profit squeezes, the enormous uncertainty created by periods of volatile inflation make it extremely difficult for a small business owner to efficiently run his business.

Small businesses do not benefit from the presence of specialized advisers who can help them anticipate changing market conditions. For example, a small business who must bid for contracts has to make bids based on a set of perceived costs.

If those costs are constantly changing, it is hard for the small business owners to know what to bid without underestimating their costs. A larger, more diversified firm, on the other hand, may be able to offset losses on a contract with returns from other operations.

When you take all of these adverse effects into account, it becomes clear that inflation places small businesses at a competitive disadvantage.

Mr. Chairman, it is truly unfortunate that we find ourselves again in this inflationary quagmire for it requires corrective actions that will again place an undue burden on small businesses.

We are extremely disturbed that in the aftermath of the inflation induced recession of 1974–75, fighting inflation has become a matter of rhetoric and symbols. Our Government has refused to put its house in order and small businesses are being severely injured once again.

If inflation is allowed to run unabated, small business loses. If this Nation takes the cure, small business loses. We are enormously concerned that after we take the cure, the Federal Government will again proceed on its merry way until the same set of problems facing us require a cure once again.

In our view, an integral part of any anti-inflationary cure is a prudent monetary policy. So long as the Federal Reserve maintains a stable and reduced rate of growth for the money supply and so long as the Federal Government reduces its expenditures, nonimal interest rates will drop as will inflation.

But to be sure, small business will bear the brunt, as they are now, of a more restrictive monetary policy. To be sure, small businesses will be rationed out of the commercial loan market as they are now.

As this occurs, small businesses will lose their only external source of funds and it will be only a matter of time before they begin to drop off like flies.

Unlike large businesses who have access to the equity markets, the bond markets, commercial paper markets, and the Eurodollar markets, small businesses have nowhere else to turn when commercial banks turn them down.

It is our opinion that it is precisely this lack of financing alternatives that has to be addressed. It is the lack of financing alternatives that forces small businesses to bear a disproportionate burden during periods of restrictive monetary policy.

The principal reason for this is a complete lack of demand for the small business loan market. By regulatory mandate, the commercial banking industry has a virtual monopoly over the small business loan market and are under no competitive pressures to be more aggressive in servicing small businesses.

As in most instances, increased competition in the commercial loan market would insure a wider array of financing alternatives to small business, which would lessen the impact of restrictive monetary policies.

More competition for the small business loan market would force lenders to pay closer attention to the specific needs of small businesses.

Until more competition is fostered for small business lending, small businesses will continue to bear the brunt of restrictive monetary policies. Thus, a greater number of lending institutions should be given authority to extend commercial loans.

In conclusion, Mr. Chairman, inflation can only be reduced by following more responsible fiscal and monetary policies by eliminating excessive and costly Government regulations, by handling our energy problem, and by eliminating structural disincentives to increase production.

The elimination of inflation would benefit small business in the entire country more than any other accomplishment. We recognize that reaching that goal will take years of persistence and courage in the face of mounting political pressures.

There are no simple solutions to the inflation problem. There is no avoiding the painful short-term effects associated with long-term anti-inflationary policies.

Small business is willing to share these burdens in order to attain our primary national goal. However, efforts should be made to spread the burden more evenly.

We urge that closer attention be paid to the competitive structure of our financial industries in order to increase competition for the small business loan market. If the burden of inflation and anti-inflation policies is to be borne more evenly across our economy, it is imperative that a greater number of alternative sources of financing be made available to small business.

We urge that this Congress encourage development of new innovative techniques that will better meet the financial needs of small business. The past years of persistent inflation have exposed the shortcomings of our financial system in meeting small business' needs.

While we must never abandon policies to reduce inflation, we must also never abandon efforts to improve the responsiveness of our financial system to all segments of the economy.

Thank you, Mr. Chairman.

Mr. LaFalce. Thank you very much.

Mr. Bereuter?

Mr. Bereuter. Thank you, Mr. Chairman.

Thank you for your testimony.

I think one of the most interesting parts of your testimony is table 6. I see that you reference some tables. I do not happen to see where you reference, but I think you are talking to some of your testimony on page 10.

Mr. Zayas. Table 6 is from the Flow of Funds Accounts of the Federal Reserve Board.

Mr. Bereuter. The most remarkable occurrence is between 1974 and 1975. The amount of funds raised in the U.S. credit market by the Federal Government in 1974 was $11.8 billion, according to this chart, and it moved clear up to $85.4 billion in 1975.

At the same time, the corporate, which had been running at almost $60 billion or more, in 1974 was $81.8 billion and dropped to $37 billion.

Tell us, for the record, what happened and why it happened.

Mr. Zayas. Primarily because the corporate sector was more able to tap different markets, different markets that are unavailable to small business. This is the key.

I have gotten calls in the last 6 months from different areas of the country asking why it is that small businesses are impacted more than large businesses.

There certainly are a great number of corporate small businesses, but by and large, corporate businesses tend to be large.

Mr. Bereuter. The interesting point is what the Federal Government did in the market that year. It was $85.4 billion in 1975.

Mr. Zayas. Of course, we all know what the effect of that is. It crowds out many of the private borrowers.

Mr. Bereuter. Corporate and noncorporate, including small business corporate and noncorporate, what happened to them?

Mr. Zayas. I am sorry?

Mr. Bereuter. What happened to small business between 1974 and 1975?

Mr. Zayas. A tremendous amount of small businesses failed.

Mr. Bereuter. Right. I think the point that needs to be made is what the Federal Government did in the credit market at that point in time and its impact, therefore, on businesses, and especially small business.

Mr. Zayas. Small business, all of a sudden, is getting a lot of attention. There is a big demand now for economic analyses of the impact of fiscal and monetary policies on small business.

This is one of the most important areas, in our opinion, to estimate the crowding out effect, if you will, of Government borrowing, specifically on small business.

A lot of work has been done on an aggregated basis, but not enough work has been done on what it means to small firms. This is primarily a function of the lack of data.

I hope the Federal Reserve Board is encouraged to collect data on loans by size of borrowing firms, so that over a period of years we will be able to more accurately assess what that impact is.

Mr. Bereuter. I think it is very important that we have that kind of information. But commonsense tells you that it has a tremendous effect on crowding out the non-Government borrowers from the market.

Thank you, Mr. Chairman.

Mr. LaFalce. I think you have raised an excellent point. I want to pursue that a bit.

The fact that the Federal Government is borrowing more, or raising more, in the U.S. credit markets on a percentage basis, does not necessarily mean that crowding out is taking place. It could mean they are borrowing in substitution for private sector borrowing.

Do you have any analysis of at what point the Federal borrowing has shifted from substitution for private sector borrowing and crossed the line over to crowding out? It is at the point where crowding out takes place that you begin inflationary pressures.

Mr. ZAYAS. Absolutely.

Mr. LAFALCE. Do you agree?

Mr. ZAYAS. Yes, I agree. Unfortunately, we do not know of any statistical sources that would allow an analysis to give you a more empirical based judgment.

Mr. LAFALCE. That is regrettable.

Mr. BEREUTER. In fact, the Federal Government is borrowing on behalf of small businesses.

Mr. LAFALCE. No. It is the recessionary periods. The Federal Government comes in with countercyclical programs. It is not that they are crowding out the private sector. There is no demand from the private sector because of the downturn in the economy.

Therefore, the Federal Government comes in in a countercyclical way and you do not exert an inflationary pressure because there is no competition within the credit markets. But as soon as you do have competition between the Federal Government and the private sector, then you switch from substitution by the Federal Government to competition or crowding out.

That is when, I think, under my understanding of economics, that the inflationary pressures begin. So, I wanted to know if there are any economic analyses.

Mr. BEREUTER. I understand your point. But there is that additional point that we would need to know about. That is: How much is the Federal Government borrowing on behalf of farmers instead of the farmers borrowing directly? There is an increased amount of activity in that direction.

Mr. ZAYAS. The question also becomes: Does that prolong getting the credit markets back into a state of equilibrium? There are the things that have to be addressed.

Mr. LAFALCE. Has your economic department undertaken any attempt to?

Mr. ZAYAS. We have attempted to, and at this point we have been discouraged by the lack of data.

The problem is there is no data by size of business over a sufficient period of time to be able to make good analyses.

Mr. LAFALCE. Could you provide me, as soon as you can, with the type of data that you think would be necessary in order to perform the type of analysis that you think is desirable?

Mr. ZAYAS. We would be more than happy to do that, Mr. Chairman.

Mr. LAFALCE. I noticed that the increase in Federal borrowing that took place seemed to coincide with the larger Federal deficits. That is very understandable.

Would you have data for 1978 and 1979 with regard to U.S. credit markets?

Mr. ZAYAS. I suspect that those numbers are available from the flow of funds account. We have not taken a look at them at this moment.

Mr. LAFALCE. We might be able to get them from the Federal Reserve, because they are testifying tomorrow. I think that would be very interesting.

I share your concern and I am deeply disturbed. You pointed out on page 11 of your written testimony that in your judgment commercial banks are rationing small businesses out of their commercial loan portfolios. That is your statement.

You also state that the only study of which you are aware was the study based upon data collected in 1955 and 1957.

Mr. ZAYAS. That is correct.

Mr. LAFALCE. Did the Federal Reserve, or any banking institution differ with the Silber and Polakoff study?

Mr. ZAYAS. Yes. There is a wide body of opinion on whether commercial banks ration small businesses during cyclical peaks.

But we have a very large membership, Mr. Chairman. We are in close contact with them. It is interesting that during periods of high inflation we get a tremendous increase in the amount of letters from our members complaining about their inability to obtain credit.

At the same time, we have a quarterly economic report which was started in 1974. One of the questions that is asked in the quarterly economic report is: What is your single most important problem you face today?

Interestingly enough, since 1974, inflation has been ranked No. 1. Obtaining credit and interest costs typically throughout the course of the business cycle remains in the rank of 5 or 6. As the economy becomes overheated, and inflation starts to pick up, obtaining credit and interest costs steadfastly move up.

At this point, obtaining credit and interest costs are ranked No. 2. That tells you something. It tells you something about the financial system.

During those inflationary periods, the current financial system is unable to meet the needs of small business because there is not enough diversity.

Mr. LAFALCE. Let us get into that lack of diversity.

The only suggestion you have made is that a greater number of lending institutions should be given authority to extend commercial loans, especially to small businesses. I do not recall if I would be really advocating that aggressively.

That is an issue that we recently considered, as you know, when we passed less than a month ago the financial institutions deregulation bill. We did give somewhat greater powers to our thrift institutions.

Did you have very much voice in that bill? Did you articulate a position?

Mr. ZAYAS. Unfortunately not. It was because of limited staff and other priorities.

Mr. LAFALCE. It seems to me that one of your biggest problems is debt financing. That is your biggest problem, really. The only approach and the only solution that you have come up with for that is greater competition and, therefore, greater powers. I think that should have been one of the highest priorities.

Mr. ZAYAS. The banking reform bill is a positive step, a step in the right direction.

I would like to see it carried a little further.

Mr. LAFALCE. Does your staff have a position on Federal preemption of usury rates that might exist because of State laws for consumer loans?

Mr. ZAYAS. No; we do not have a position on that.

Mr. **LaFalce.** Well, that is going to be a hot issue. We did preempt, as you know, usury laws for residential mortgages, for example. Now I understand there might be a movement underfoot.

If you have some thoughts on that in the future, let me know.

Some people are making the argument that the McFadden Act has a harmful impact on the small business community because it lessens the competition that can exist. I should say it lessens the diversity that can exist in providing financial resources.

Have you taken a look at the McFadden Act and its impact on small business?

Mr. **Zayas.** We are currently addressing that.

Mr. **LaFalce.** Are you?

Mr. **Zayas.** Again, we are confronted with problems in analyzing loan data on a State-by-State basis where we cannot get loan data by size of firm.

But we do think a lot of attention should be directed toward analyzing the potential impact that the McFadden Act could have on competition among small business lenders.

There are good arguments on both sides. Some people believe that unit banking States, by virtue of the fact that a bank is limited to a particular geographic area is forced to look more closely at its customers within its given area.

Therefore, that type of system might promote more competition for the small business. At the same time, the inability to cross State lines may inhibit competition within the industry to the point that it may offset that.

We do not know, but we believe it should be addressed and it should be addressed in the context of small business.

Mr. **LaFalce.** Precisely and I intend to address that issue in the future. I intend to have hearings on exactly that point. I would hope that you would give as much attention to it as you can.

Mr. **Zayas.** We would be happy to.

Mr. **LaFalce.** Mr. Bereuter, do you have any further questions?

Mr. **Bereuter.** No thank you, Mr. Chairman.

Mr. **LaFalce.** I have one more question.

You are an economist. Which comes first and which causes what? Does inflation cause high interest rates, or do high interest rates cause inflation.

My answer would be both. Higher inflation certainly causes high interest rates and higher interest rates do have a tendency to exacerbate inflationary pressures.

But can you be a little more sophisticated than I am able to be? If we had to divide it up, would inflation not be a cause of high interest rates? Would that not be a much greater problem than interest rates exacerbating inflation? How could we apportion blame without a percentage basis? How could you help me explain that to my constituency a little bit better?

Mr. **Zayas.** The first thing I would point out is that if you take a look at the statistics over a long period of time, you will see a very strong correlation between rate of inflation and interest rates whereby the rate of inflation leads interest rate increases.

Mr. **LaFalce.** I am sure the Federal Reserve Board will say we are not in any way the cause of higher interest rates, inflation is being caused by a multiplicity of factors, interest rates are trailing inflation, and we in no way are pegging or causing higher interest rates.

We will have them before us tomorrow. I do not want to anticipate their argument, but I am sure that is what they will say.

Mr. **Zayas.** I would agree with the Federal Reserve Board.

Mr. **LaFalce.** You would?

Mr. **Zayas.** Yes.

I would also like to address at this moment another issue regarding productivity and inflation. There again you have a chicken and the egg problem, if you will. I think it is pretty clear that by increasing productivity, you are going to reduce inflationary pressures.

But in reality it is high rates of inflation that lead to decreases in productivity for various reasons. The primary reason is the tremendous uncertainty that is created by an economic environment characterized by rampant inflation.

It becomes very difficult for the business sector, No. 1, to engage in long-term projects that have a perceived rate of return over a period of 10 years when they have no idea what is going to be happening to the present economy.

That acts as a disincentive toward research and development, toward developing new innovative techniques in the economy..

This more than anything else has a very adverse effect on productivity gains in the economy. If you just take a look at the last couple of business cycles, you will notice that the productivity decreases in the economy have been following high rates of inflation.

Mr. **Bereuter.** I would like to ask this. What is the basis, in your judgment, of that difficulty in forecasting?

Mr. **Zayas.** I do not understand the question.

Mr. **Bereuter.** You are having great difficulty. What is the basis?

Mr. **Zayas.** What is the basis for that?

Mr. **Bereuter.** Yes.

Mr. **Zayas.** Primarily it is because of tremendous instability within the Federal Government.

Mr. **Bereuter.** I think that you and the gentleman from the Home Builders Association have been very, very easy on the Congress and its role in this whole problem.

Mr. **Zayas.** If I have been, I did not mean to be.

Mr. **Bereuter.** It is has been criticism of monetary policy rather than fiscal policy.

Mr. **Zayas.** I do not have a criticism of the current monetary policy because I believe very strongly, as does NFIB, that what the Federal Reserve is doing right now is an absolutely necessary ingredient in reducing the rate of inflation.

Mr. **Bereuter.** That just came out a minute ago in your response to the chairman.

Mr. **Zayas.** The Federal Government must reduce its expenditures and attain a balanced budget, but a balanced budget itself is not enough. Once we get there we have to take corrective actions to eliminate structural disincentives to production, that encourage savings, not consumption.

All of these things taken together are necessary. But a restrictive monetary policy is absolutely essential.

Mr. LaFalce. Thank you very much, Mr. Zayas, for your testimony. You have been very helpful.

Mr. Zayas. Thank you, Mr. Chairman.

Mr. LaFalce. We will now hear from Paul Reardon, economics division of the U.S. Chamber of Commerce.

He is accompanied by Robert Shelton, general manager of Anderson Tool & Engineering Co., and Mr. David Martin, president, Allied Window Manufacturing of Cincinnati, Ohio.

Gentlemen, welcome.

Mr. Reardon, you may proceed.

TESTIMONY OF PAUL REARDON, DIRECTOR, INFLATION FIGHT CENTER, U.S. CHAMBER OF COMMERCE

Mr. Reardon. Thank you, Mr. Chairman.

I am Paul Reardon, an economist and director of the Inflation Fight Center of the Chamber of Commerce of the United States.

Accompanying me today are two small business members of the U.S. Chamber. Mr. Robert Shelton is general manager of Anderson Tool & Engineering, Anderson, Ind. David Martin is president of Allied Window Manufacturing, Cincinnati, Ohio.

I will make my remarks very brief and then these two gentlemen will tell their own stories of the impact of inflation on their businesses.

The Chamber of Commerce of the United States is the world's largest business federation, comprised of more than 94,000 business firms, 2,600 chambers of commerce in the United States and abroad, and 1,300 trade and professional associations.

Mr. Luken. Excuse me, Mr. Chairman. I would like to interject for a moment.

I would like to congratulate you, Mr. LaFalce, for having these very timely hearings in depth. You know Mr. LaFalce's penchance for thoroughness. This is a subject which requires that kind of painstaking inquiry so that we can somehow sift through this plethora of problems.

So, I congratulate the chairman for this. I feel privileged to be a part of it. I think it is vital work.

Mr. Chairman, I would also like to introduce David Martin from Cincinnati. He is not only working here on the Hill today, but he spends a good deal of his time for small business. He has been chairman of the small business committee of the Cincinnati Chamber of Commerce. He was a very active participant in the White House Conference and the preliminary meetings.

I am very proud that he reperesents Cincinnati in this endeavor today.

Thank you, Mr. Chairman.

Mr. LaFalce. Thank you.

Mr. Reardon, you may proceed.

Mr. Reardon. Inflation has been higher in each successive year since 1976. Each year our Nation staggers under a worsening inflation rate, the negative impact on small business is greater.

The Chamber has repeatedly asserted that inflation is the No. 1 national economic issue facing America, and a particular burden on small business.

Inflation puts small business in a bind. It has no choice but to pass increased costs on to the consuming public—if it can. Often it cannot and in these cases great hardship results. When its prices do rise it bears the brunt of public antagonism over rising costs.

Therefore, inflation must be seen not only as sapping the economic strength of small business, but also as a drain on the entrepreneurial spirit.

Inflation's cost must be measured equally in monetary and in human terms. It adds greatly to the many risks small business already face.

The uncertainty of planning that high inflation creates is one of these risks because of the large variation in inflation rates in future years as a result of it being much greater than zero.

Can we rely upon Government to control it?

Most of the responsibility for dealing with inflation rests with the Government itself in its approaches to spending and monetary control.

Recently, the Federal Government has begun to take steps to slow the growth of money and tighten controls on spending. More needs to be done.

We must adopt policy changes to eliminate the inflationary psychology that has the country in its grip. Current economic policy promotes this psychology through excessive Government spending and measures that stimulate consumption at the expense of savings, investment, and productivity.

These policies will lead, at best, to economic stagnation and, at worst, to still higher inflation and a deep recession.

This inflationary psychology took time to develop and cannot be broken overnight. A policy reversal aimed at stimulating capital formation and at higher productivity will break the upward spiral of inflation.

The U.S. Chamber has a number of specific recommendations to deal with inflation. I shall go through those briefly.

One, cut Federal spending in fiscal 1981 to 21 percent of gross national product.

Two, enact a spending limitation to move spending from 21 percent of the gross national product in fiscal 1981 to 20 percent in subsequent years, as H.R. 5371 introduced by Mr. James Jones of Oklahoma, would do.

American consumers overwhelmingly favor a ceiling on Federal Government spending. The latest quarterly survey of consumers, conducted last December for the U.S. Chamber Survey Center by the Gallup organization, found 65 percent favoring a law that would require spending to be "kept below 21 percent of GNP in the next year's budget, and below 20 percent in years after that."

Only 15 percent opposed such a law to limit Federal Government spending.

Three, cut Federal taxes by $25 billion in 1980 to reduce the tax bias against capital formation by: One, enacting the capital cost recovery system proposed in H.R. 4646; two, cutting corporate rates; and, three, reducing the tax bias against individual savers and investors.

The chamber supports the recommendation of the Joint Economic Committee in this year's report that economic growth and stabilization policy must start from the premise that our market economy is driven by incentives to work, save, and invest.

Policies in harmony with those incentives will improve productivity, accelerate economic growth, and reduce inflation. The chamber recommends that $25 billion in tax relief—half directed at reducing barriers to saving and investment—be enacted at once.

The chamber has concluded, as did the JEC, that reducing tax impediments to investment will help reduce inflation.

Immediate supply-oriented tax reductions are needed to remove the disincentives to investment which have dragged down productivity and contributed so much to inflation.

Specifically, adoption of the "10–5–3" capital cost recovery system proposed in H.R. 4646 and a two-point cut in corporate tax rates would promote capital formation and stimulate productivity.

These beneficial changes would add to real economic growth without worsening inflation in the short run; moreover, the prospect of further increases in productive capacity would significantly reduce inflation.

Four, limit taxes over the longer run to a share of the gross national product consistent with the lower spending limit we propose. Taxes and spending should be balanced over the course of the business cycle at the lowest expenditure level which will provide essential public services and meet the requirements of national security.

Five, support the retroactive freeze on Federal employment resulting in a reduction in force through attrition throughout the calendar year. This will keep fiscal 1980 outlays lower.

Six, freeze regulatory agency budgets as a sign that Congress is serious about reducing regulatory impediments to increasing productivity and growth.

Seven, freeze the issuance of new regulations except those deemed absolutely necessary under the law.

Eight, move toward a budget balanced over the course of the business cycle. A balanced budget should not be achieved in fiscal 1981 by arbitrarily allowing unlegislated increases in taxes to create the illusion that the Government's fiscal house is in order.

Nine, repeal the Davis-Bacon Act. The artificially high pay scales accelerate inflation through higher construction costs. In 1979, the GAO estimated that Davis-Bacon pay standards had cost the Federal Government and taxpayers $715 million in 1978. Inflation would bring this figure to over $850 million today.

Ten, move to restore control of the entire budget by changing legislation that allows for automatic escalation.

Escalation formulas should be changed so that increases in Federal transfer payments reflect only the increased costs actually incurred by the recipients. It is impossible to reduce spending significantly as long as 76 percent of the budget is considered uncontrollable.

Eleven, establish a minimum wage differential for youth.

Compliance with minimum wage standards appears to be the most burdensome for small businesses. The minimum wage is harmful to the economy. It does not achieve its objective of giving lower income people a guaranteed floor on their income. Instead, it creates unemployment for America's youth.

It creates inflation in two ways: The legislated increases add directly to production costs and prices and the higher youth unemployment causes increased Federal spending—for example, when Government creates make-work dead end jobs because apprenticeship and learning opportunities are virtually unavailable to young people in the private sector.

And, twelve, reject all controls on wages and prices.

In conclusion, reducing inflation this year and in coming years is a very high priority for the U.S. Chamber and we hope it also is for others.

I would be happy to respond to any questions you may have.

Thank you.

Mr. LaFalce. I will withhold my questioning until we have heard from Mr. Shelton and Mr. Martin.

Mr. Shelton?

You may proceed.

TESTIMONY OF ROBERT SHELTON, VICE PRESIDENT AND GENERAL MANAGER, ANDERSON TOOL & ENGINEERING CO., INC.

Mr. Shelton. Thank you, Mr. Chairman.

My name is Robert Shelton and I am vice president and general manager of Anderson Tool & Engineering Co., Inc., located in Anderson, Ind.

I want to thank you for the opportunity to speak to this committee. Small business provides 80 percent of the private sector employment in this country and generates 87 percent of all new jobs.

Your effort to stay in touch with small business during these critical times is essential and is appreciated.

Anderson, Ind., is an automotive city 40 miles northeast of Indianapolis. It is the home of Guide and Delco Remy divisions of General Motors who employ approximately 15,000 people.

Because of the continuing automotive sales slump, Anderson's unemployment is at 17.5 percent and is the highest in the United States. As a comparison, unemployment nationwide was 17 percent during the Depression. I understand that further GM layoffs are likely in the near future. This problem is further compounded by a lack of sufficient unemployment compensation funds due to a Federal budget error.

Anderson Tool & Engineering has been in operation for 33 years. We have no product line, but instead build special machinery, tools, jigs, and fixtures and provide precision machining services. We serve a wide cross section of U.S. industry including automotive, custom packaging, off-highway equipment, food processing, and consumer products, to name a few.

All of our work is obtained through competitive bidding. With few exceptions, our sales are for low quantities and orders are completed in 6 months or less.

Special head lamp assembling equipment, box forming machines, diaper production lines, phonograph record sealers, and special machine tool bases are examples of the many products built by us to customer supplied prints and specifications.

We currently employ 47 people, of whom 38 are skilled machinists and toolmakers. Should our Nation find it necessary to mobilize in a war effort, it is facilities like ours that would be the backbone for providing the tooling to get the production lines going.

Like most small business people, especially in the machining trade, our management is extremely independent and determined to be self-sufficient. We are owner-managed and are willing to plow all of our earnings back into facilities, equipment, and working capital.

We receive no special favors of Government incentives to succeed. We live or die by the same rules as publicly owned companies many times our size.

We are now convinced that we are on the "endangered species" list because of several unanswerable questions:

One, what happens should the major stockholder die? Can his survivors afford the consequential inheritance taxes or will it be necessary to sell the company to pay the tax bill?

Two, how can we provide the huge amounts of capital required to maintain a position in our highly competitive market? In 1977, we obtained a 7¼ percent, 15-year, $750,000 economic development bond for a major expansion. The debt service to this loan is $6,800 per month.

This year we should make another capital investment of the same size. If we could get money at all, the rate on these tax-free bonds would be in excess of 12 percent. Without a faster tax writeoff, such an undertaking would be foolish.

As a substitute, we are rebuilding and patching up 20-year-old to 30-year-old equipment.

Three, can we maintain adequate cash flow and hope to retain any profits under today's economic pressures? In 1979, we paid the bank and the Federal Government $20,000 more than we were able to retain in the business.

The fact that we succeeded in paying current debits, satisfied our customers, and provided incomes for 57 families barely offsets the fact that the company would have made more money by having its assets in certificates of deposits, or the short-term money market.

In 1979, customer progress payments on orders allowed us to work within our approved line of credit. In 1980, our customers are not making progress payments which forces us to carry total inventory costs until delivery.

For this reason, our 1980 borrowing needs could easily be twice our current line of credit. We have no assurance that this money will be available.

Of course, 20 percent plus prime rates in 1980 as compared to 11 percent to 12 percent in 1979 will make it difficult to generate any profit. This problem is compounded because we have had to bid jobs at break-even labor rates, or less, to secure work in the first quarter.

We are hoping that efficiency improvements will allow us to keep our head above water. We have abandoned trying to make long-range plans in our current environment. Survival is our major objective this year.

Four, will State and Federal agencies eventually pile on more regulations and paperwork than we can bear? It often appears to large and small business alike that regulation is what Government is all about.

March 1980 Business Week reported that "agencies with regulatory responsibilities, 28 of them in all, are slated for a 12-percent increase in 1981."

In 1978, U.S. businessmen spent 143 million man-hours filling 4,400 different Federal forms at a cost from $25 billion to $32 billion.

Gentlemen, I trust that Congress understands the impact that a mass failure of small business can have, and the speed with which such a disaster can occur. Every week we receive one or two auction brochures for machine shop liquidations.

Unlike the big splash of a Chrysler failure, we in small business simply slip below the murky waters silently and without notice.

By my own estimation, a 10-percent failure of small business in Indiana in 1980 would nearly double the latest unemployment from 245,000 to over 450,000. While Chrysler employs many people in Indiana, it is considerably less than the 200,000 I am talking about.

I am not very confident that a promise of a 10-percent small business failure would bring Congress to our rescue as it did Chrysler. I am not attempting to judge the Chrysler baleout: I only want to compare the magnitude of a small business failure to the Chrysler program.

Gentlemen, you probably have not the time to hear my interpretation of our current economic crisis, nor am I inclined to believe you would appreciate my version. I hope that all of you will agree with me that capitalism, democracy, and competition are the very essence of this country's economic strength.

They have been best preserved and proven valid in the small business community. Without them, small business would die and as night follows day so communism's threat to bury us will come to pass.

This Nation's government had best start nurturing the free enterprise system and stop trying to regulate it to death. The American way of life was not originally conceived as a socialistic state, but it is becoming more like one with each passing day—not through revolution, but through regulatory evolution.

I would encourage Congress to act swiftly and favorably on the 15 major recommendations developed by the 1980 White House Conference on Small Business.

I feel that priority should be given to the following areas:

One, replace, the present corporate and individual income tax schedule with more graduated rate scales, specifying the graduated corporate tax scale up to $500,000;

Two, balance the Federal budget by statute in fiscal 1981 by limiting total Federal spending to a percentage of the gross national product, commencing with 20 percent and declining to 15 percent;

Three, revise the State tax laws to ease the tax burden on family-owned businesses and encourage the continuity of family ownership;

Four, reform the social security system by including, where constitutionally possible, all public and private sector employees as contributors and more closely tie benefits to contributions to move the system toward actuarial soundness.

Limit benefits to the original old-age and survivors benefits. Freeze the tax base and tax rate at the January 1980 level. Eliminate double dipple;

Five, revise minimum wage standards by freezing standards at January 1980 levels and establishing a two-tier minimum wage by exempting teenagers, seasonal workers, and part-time workers;

Six, develop realistic capital cost recovery legislation which will reduce the writeoff period of capital assets.

Thank you for your attention.

I will be happy to answer any questions when Mr. Martin is done.

Mr. LaFalce. Thank you very much.

Mr. Martin, you may proceed.

TESTIMONY OF DAVID L. MARTIN, PRESIDENT, ALLIED WINDOW MANUFACTURING, INC.

Mr. Martin. Thank you, Mr. Chairman.

Good morning, my name is David Martin. I own a small window contracting firm in Cincinnati which employs about 23 people.

I was privileged to be a delegate to the White House Conference on Small Business, the appointee of Congressman Tom Luken, a distinguished member of your Small Business Committee.

I would like to share with you the flavor of the Conference as it addressed the problem of inflation.

At delegate caucuses around the country and at the Conference itself, small business rejected measures which would help it cope with inflation.

We did not want special consideration for our problems.

We did want action on the causes of inflation.

The message of the delegates was loud and clear and unanimous—cut Government spending.

We wanted a balanced budget in fiscal 1981. In January we were told it could not be done. In April, it is happening.

Significantly, of the 15 major conference recommendations which were submitted to the President for priority consideration, 3 of these dealt specifically with inflation.

I would like to deal with the Davis-Bacon Act.

I doubt that anyone in this room knows what the 16th option was, the one that just missed being on the President's select list, and was also an inflation issue.

It is the one which is having a dramatic effect on my business today, and may strangle my business as we try to grow tomorrow.

The No. 16 item on the small business priority list was the repeal of the Davis-Bacon Act.

Small business recognized the facts that Congress to date has tried to ignore:

(1) The Davis-Bacon Act was created 50 years ago, and the twisted form it takes today is unrelated to current conditions;

(2) The act, as acknowledged by the GAO creates over $1 billion in excess construction costs and untold administrative costs for the Government and contractors; and

(3) The act has been a sacred cow in that big business, big labor, and Government are all satisfied with the situation, even though small business and the taxpayers are suffering unnecessarily.

I submit to you that this country cannot afford sacred cows anymore.

How does the inflationary push of Davis-Bacon affect my company?

Allied Window is in a growing industry, and we are striving to be a leader in the market.

Each year we have done more work calling for commercial prevailing wage rates which are far above our normal high pay scale.

The net effect has been that in the last year I have had to double my installation pay rates on all commercial jobs, not just those dictated by Davis-Bacon.

I cannot pass on increases of this magnitude to my customers, and have had to absorb a great deal. This was a significant contributor to my company's substantial operating loss last year.

Our industry is in a monstrous squeeze, with all costs rising rapidly, and competition forcing frantic reductions in normal markups.

There will be a bloodbath in the construction and remodeling industry this year, particularly among small businesses.

Five days ago, on April 11, I checked the status of commercial construction activity at our Cincinnati office of the F. W. Dodge Co. They keep track of all jobs being bid in our area.

There were 81 jobs out for bids. Almost 80 percent of these jobs called for prevailing, or union, wage rates.

It scares me to think that 80 percent of our Nation's commercial construction activity today involves Government money, and, therefore, 80 percent of the time union wage scales are dictated by the Government.

Let me tell you of a job we did last week to replace windows in three dormitories at Xavier University in Cincinnati.

One of the dorms is seven stories and called for a commercial prevailing rate for carpenters of $14.88 per hour.

The other two dorms were four stories and called for a residential prevailing rate for carpenters of $6.47 an hour, even though they had the same windows as the taller building.

Do you believe that I can pay my people two different rates—$6.47 versus $14.88?

My people work hard and since they are on incentive, they make much more than the prevailing rate. But I pray that they do not find out what the union installers—who are not as efficient—wanted to do the job.

One final irony, and it falls in the area of Government regulation, as well as inflation.

Our general contractor was the low bidder on the Xavier job, but all the bids were rejected because he neglected to include with his bid a Federal Government boilerplate form asking for information about his previous experience with EEO reports.

He has never had any experience with EEO reports.

The form was submitted 10 minutes after the bid opening, but could not be accepted.

This ridiculous situation will result in an increase in remodeling cost of about 10 percent of $50,000 after the job is rebid.

Gentlemen, to grow or even survive in my industry, I must fight Davis-Bacon problems every step of the way, and gamble that I can continue to find and train people who want to work for their money.

I need your help.

This committee is in a position to call the question on this issue which plagues not only small business, but the entire Nation.

Thank you.

Mr. LaFalce. Thank you very much.

Mr. Luken?

Mr. LUKEN. Thank you very much, Mr. Martin, for bringing these particular problems that you have to the attention of the committee and, therefore, to the Congress.

In your opening remarks you said that the Conference in January was told there was no possibility of balancing the budget. I suppose——

Mr. MARTIN. That is the general comment from the staff people who were there who were knowledgeable about such things.

Mr. LUKEN. That certainly reflects what was going on. The President submitted a budget which was close to $20 billion out of balance in January. Through the shock of 18 percent inflation, which I believe occurred early in February, and the pressure from the Congress and from the people, this budget has now been revised and is somewhere near in balance.

As a matter of fact, it shows a surplus. But the surplus was brought about principally by the addition of a gasoline tax, a tax on imported oil. I do not know if you want to comment on that. The Congress may well be opposed to that.

As a matter of fact, I am torn right now between the importance of this particular meeting and the DOE authorization in my other meeting downstairs. I may be called away at any time because I think it is very important that we do vote and that the committee and the Congress take a position against that 10-percent import fee, and stop that import fee, which would result in a 10-cent-a-gallon increase at the pump.

I just wanted to point this out. The budget is going to be balanced. Unfortunately, to some extent it is by the additional taxes. But we still will have the situation which has not occurred for some time and which is a more healthy one. We will not be adding to the national debt, and, therefore, paying a considerable amount more in interest on the national debt.

The estimate of the interest on the national debt for fiscal year 1981 is some $80 billion. I have not seen that figure tossed around very much. We have been able to ascertain that that is the figure. It is a staggering figure. It must be close to the total of aid that this Government provides to all State and local governments and other agencies.

We pay just as much for that payment on the almost $1 trillion of the national debt than we do in aiding our citizens in some very worthwhile pursuits.

Let me ask you just one question about the Xavier job. Did you say you bid it on two different levels?

Mr. MARTIN. I had intended to bid it, but I was unable to get a bond that was large enough.

Mr. LUKEN. You did not bid it at all?

Mr. MARTIN. We did all three buildings. I had intended to bid it not knowing that until I got down to the point—I tried to get authorization through the SBA.

I could ordinarily get a bond up to a quarter of a million dollars. Praise the Lord, really, because I could not be bonded except by the SBA bond program, but they would not go the half million dollars.

So, I had to go back and——

Mr. LAFALCE. Who would not? SBA would not?

Mr. **Martin**. We never got that far. The bonding company would not. The insurance company would not go beyond the $250,000, based on my current financial situation.

So, we had to go through the manufacturer. Partly through their lack of familiarity with the type of forms that are called for, they looked at the form. They said: "Well, we have never done this before. It says about submitting something 7 days after the bid opening. I guess we do not need this." They set it aside.

This is not germane to what you are speaking of, but it is going to involve, I am sure, I hope confidentially, about a $50,000 increase in the cost of this job because it will have to be rebid.

Mr. **Luken**. Do you mean because of inflation?

Mr. **Martin**. Price increases plus, quite frankly, we bid it low. We bid it very, very tight because we wanted the job very, very badly.

That is a competitive reality.

Mr. **Luken**. Are you saying that you will bid it on a two-tier level? Are these separate contracts for the two buildings?

Mr. **Martin**. No. It was one bid for the entire job. It included one seven-story building and two four-story buildings.

Mr. **Luken**. Are these subcontracts within the full contract?

Mr. **Martin**. There could be. There would be one contract for the construction work. The installation conceivably could——

Mr. **Luken**. You are a sub?

Mr. **Martin**. We are a sub, but we would be responsible for the installation.

Mr. **Luken**. There would be one contract on the seven-story building and one on the four-story building?

Mr. **Martin**. No; basically it was one job for the—one subcontract for the entire amount of work.

Mr. **Luken**. Then you could not bid it on the two-tier level?

Mr. **Martin**. No; I could not. That is really what I was trying to point out. The reality of life is that I cannot say that we are going over and work on this one rate and go and work on the other for the other rate.

Mr. **LaFalce**. Were you bidding at Davis-Bacon rates for the entire job?

Mr. **Martin**. Yes.

Mr. **Luken**. Of course; you have to.

Mr. **Martin**. My people work productively enough that they can exceed the Davis-Bacon requirements but only because they work harder. If I had to pay them on an hourly rate of $14.88 an hour, my costs would increase very substantially.

Mr. **Luken**. You give this example of a construction contract which has two buildings of different sizes. One is arbitrarily assigned a residential rate and the other is arbitrarily assigned——

Mr. **Martin**. Up to four stories of residential construction is the residential rate.

Mr. **Luken**. Even if there were no Davis-Bacon Act, would there not be in construction some basic differences between the big multimillion dollar jobs and the residential jobs.

By way of explanation—there was no requirement that it be union work. That is not an element in this at all. We do not do very much work, new construction, which requires union personnel. I have no objection to the union. When I go on an union job, I find union people and I do it. That is not for me to say.

But in this particular situation, where there is not a basic requirement that they be union personnel, the rate permits the union contractors to bid those kinds of rates which are not really reflective of what private work would be in that city.

Mr. Luken. The general contractor was an union contractor?

Mr. Martin. No.

Mr. Luken. You were bidding with a general who was not union?

Mr. Martin. The general contractors were typically people like myself.

Mr. Luken. This was primarily a window job?

Mr. Martin. That is right; it is strictly windows. It was strictly a window replacement job. There was no actual construction at all. We go up. We tear the window out. It is the same thing we might do in your home except that it is many hundreds of windows.

I do not know if I answered your question.

Mr. Luken. Yes; that does clear it up. It certainly does make your point.

Mr. Martin. It is not necessarily 80 percent of the dollars, but 80 percent of the jobs call for Davis-Bacon rates. The vast majority of those—probably 95 percent of those—called for commercial rates. Probably two-thirds of the jobs were actual Federal money.

Mr. Luken. I would like to make one comment on the other testimony that urged on the direction that the country is going in, of paternalism and socialism. I forget exactly how you characterized it.

Mr. Shelton. Socialism.

Mr. Luken. You did, at the same time, say what you felt. I think these are good proposals. You mentioned that a graduated corporate tax be invoked and the tax burden on family ownership would be invoked.

I think if we pursued it you would probably urge a special kind of capital cost recovery.

Mr. Shelton. Yes, sir.

Mr. Luken. There are people who would suggest that would be; that is, that all of those measures would be paternalistic.

I am in favor of all of them that you have suggested. But I am not just so sure that we should make these very broad characterizations that this is the direction we are going.

There are people who think that these would be of that category.

Mr. Shelton. I believe that socialism is a situation where we do not have the opportunity so much to participate in growth and wealth, where we receive wealth by arbitrary distribution.

I think the main thing that we can do in this country is to allow us to take the fruits of productivity and reinvest it in productivity so that we can create jobs and buy new machinery and get our ability to compete in the market up so that people will not have to be on welfare. They will have jobs.

I know that our productivity in the United States is going up at a rate of 1.5 percent. In Japan it is up 8.5 percent per year. And they do not have any capital gains tax.

So, let us reinvest it and not distribute it.

Mr. **Luken.** If we are comparing and contrasting our economy with Japan's, we could go on all day.

Mr. **Shelton.** I am sure of that.

Mr. **Luken.** I have even seen some figures. I believe you also urged that we pass a restriction that the Federal spending should be a certain percentage of the gross national product. I like the idea.

But I have also seen figures that Germany, for example, which has a lower inflation rate than we do, has twice the percentage of Federa spending.

Mr. **LaFalce.** And Sweden.

Mr. **Shelton.** Yes; take a look at——

Mr. **Luken.** These comparisons can be odious.

Mr. **Shelton.** But take a look at the kind of government they ar also.

Mr. **Luken.** What do you mean?

Mr. **Shelton.** You have pretty much a socialist-type country whe you get into Sweden.

Mr. **Luken.** But in Germany they keep that inflation rate down.

Mr. **LaFalce.** Sweden also.

Mr. **Shelton.** That is because of productivity.

Mr. **Luken.** I am not sure I follow you, but in any event, the comparisons——

Mr. **Reardon.** On the capital cost recovery, it is essential in any investment to make the investment profitable. The most elemental part of that is to recover the initial investment after a given period of time, not just the nominal dollars at the end of the period, but in real dollars.

With the underdepreciation that we have now because of the high inflation, business cannot do that. We desperately need that.

Germany does not tax in the same way we do. They do not tax investment as heavily as we do.

Mr. **Luken.** I am sure you are correct. I am just saying that making one comparison does not really complete the picture.

I certainly agree with the thrust of what you say. I am in favor of all these legislative proposals that we have discussed. And I am working for them.

Thank you, Mr. Chairman.

Mr. **LaFalce.** Mr. Bereuter?

Mr. **Bereuter.** Thank you, Mr. Chairman.

Gentlemen, thank you for giving your time and coming to testify.

Mr. Martin, I was just as surprised as you were apparently when you found out that 80 percent of the commercial construction activities involve the prevailing wage rate. I would think that is considerably higher than it is across the Nation.

Mr. **Martin.** I hope so.

Mr. **Bereuter.** I know it is in my own district.

I do not discount for a minute that the application of Davis-Bacon is an inflationary factor that increases costs unnecessarily in many, many occasions.

I would like to know if you can provide me with some figures, Mr. Reardon, eventually as to what the percentage might be for the Nation as a whole, for this moment, if you have access to such information.

Mr. Martin, perhaps you could also.

I might surprise you in saying that I do appreciate your version of how we got to our economic situation today.

Mr. Reardon, you have a comment in your testimony:

> A balanced budget should not be achieved for fiscal year 1981 by arbitrarily allowing legislative increase and taxes to create the illusion that the Government's fiscal house is in order.

Do you think that is what is being done with the current proposal to balance the budget?

Mr. REARDON. Yes, sir, I do. Just looking at the figure for last year and the figure for fiscal 1981, the tax increases are going to be about $88 billion. Some of that increase can be specified. Much of the increase comes as a result of the progressivity of the income tax structure where a 1-percent increase in your personal income, results in a 1.6-percent increase in your personal taxes.

Much of it is explained that way with the very high inflation rate, which probably will be about 14 percent in terms of the CPI this year.

But there is also $14.5 billion on the windfall profits tax and there is another $10 or $12 billion on the proposed gasoline tax and a couple of other sources: $3.5 billion on cash management and that sort of thing.

That facilitates balancing the budget, but at a rather high level. We believe that, while the budget should be balanced over the business cycle, it should not be balanced in this way.

We have to get started right away at rebuilding the economy. The economy, in effect, is in a state of disrepair. The way to do that is by reducing tax disincentives.

Mr. BEREUTER. I appreciate your comments. So many people who speak for balancing the budget assume that means we are going to reduce spending. It does not mean that at all. We have an outstanding negative example right now. The greatest tax increases ever suggested to the public is their method of moving toward the balanced budget. There are two ways to balance the budget.

One is to increase taxes and the other is to cut spending. That is exactly what is being proposed right now.

It is not only corporations that are feeling the increased taxes. I noted that as a proportion of family income, the individual family will pay the largest percentage of its income in taxes for any year since 1944, the peak expenditure year for World War II, under the current proposals.

Mr. REARDON. I agree. This is certainly changing the attitudes of the public toward the effectiveness of Government and what they are paying for.

Mr. BEREUTER. Thank you, gentlemen. We can commiserate together.

Mr. LAFALCE. Mr. Reardon, I have a few questions.

First of all, you support H.R. 4646, generally known as the capital cost recovery system, or a 10-5-3 accelerated depreciation program.

It is my understanding that although this is the position of the U.S. Chamber of Commerce, virtually all small businesses in America believe that the overwhelming benefit of the bill that you advocate today would be derived by big business and that small business, which comprise the overwhelming percentage of the membership of the U.S. Chamber of Commerce, would get peanuts under 10-5-3.

That is the basic reason that the White House Conference on Small Business did not come out in favor of H.R. 4646 but did come out in favor of accelerated depreciation, not articulating how, but some type of accelerated depreciation program that would better distribute the benefits across the board, taking special cognizance of the special problems of small business.

Would you comment on that?

Mr. **Reardon**. Well——

Mr. **LaFalce**. It seems to me that H.R. 4646 could be cast as anti-small business.

Mr. **Reardon**. Well, I certainly do not believe that. We have——

Mr. **LaFalce**. Small business organizations have so testified.

Mr. **Reardon**. Well——

Mr. **Luken**. The word is out.

Mr. **Reardon**. We are not convinced that the overwhelming number or proportion of small business people feel that way. 10-5-3 is the accelerated depreciation bill which we support. We believe that it has moved very far in the Congress. At this time it is the most likely bill to be enacted. We support it. We would like to see it enacted as soon as possible.

It has features for depreciation of trucks and automobiles and equipment. We believe that would benefit all business.

Mr. **LaFalce**. Is that what we need to stimulate savings and capital formation and productivity in our society, stimulate the purchase of automobiles and trucks?

Mr. **Reardon**. My point is that many small businesses rely upon trucks and utility vehicles.

Mr. **LaFalce**. Is that really supply-side economics when you get down to that aspect of it? Or, are you really talking demand-side economics through that aspect of accelerated depreciation?

Mr. **Reardon**. Not necessarily. We are talking about enabling all businesses, large and small, to recover the initial capital costs of investment, whether it is a truck, equipment, or whatever.

We have so much energy inefficient equipment in the country that needs to be replaced.

Mr. **LaFalce**. My basic point is this. I feel that the U.S. Chamber of Commerce, whose membership is largely the small business community of America, in greatest parts, speaks on behalf of the big business community of America to the detriment of the small business community.

I think that the voice of small business should be given greater heed within the counsels of the chamber of commerce than it has in the past. When the chamber of commerce speaks, they might be speaking in a manner that is more reflective of their total membership than what I consider to be the predominant minority.

Mr. **Reardon**. I have to disagree with you, sir. I think there is no more effective spokesman for all business—large and small—than the chamber of commerce of the United States.

If any of our policies are policies that work against small business, then that is an error and the sort of think that would be corrected.

We work for the reduction of inflation, for example, more effectively, I think, than most organizations in town. Small business directly benefits from that

Our taxation policies for the improvement of taxation with regard to saving would benefit small business and increase the capital available for investment for them, the rollover accounts, the reduction of maximum marginal tax rates.

Mr. LaFalce. We could go on for a good period of time on that.

You say you want to cut spending in fiscal 1981 to 21 percent of the GNP. You probably have come up with some estimate of GNP for fiscal 1981.

In dollar figures, what is your estimate of GNP and in dollar figures, what would 21 percent of that be? What would be the difference between 21 percent of your estimated GNP and the Federal budgetary outlays proposed by President Carter in his March budget?

Mr. Reardon. I am sorry, but I do not have all of those figures with me. We are talking about budget reports from the Senate and House now without outlays in the neighborhood of $611 billion or $612 billion.

By the House estimate, I believe that is 21.9 percent of the GNP and 21 percent of GNP would be probably $25 billion under that.

I can correct these figures later for the record. We would urge those kinds of cuts in spending to really indicate that the Congress——

Mr. LaFalce. But you are also going for a $25 billion tax reduction, too, are you not?

Mr. Reardon. We believe that if we have to give up something in fiscal 1981, that tax relief that is necessary to increase capital formation and increase investment or the balanced budget, we prefer to give up the balanced budget.

Mr. LaFalce. Really? So, the chamber of commerce's position is this: Given a choice between tax cuts and the balanced budget, you will take the tax cuts and forego a balanced budget?

Mr. Reardon. We think it would be possible to balance the budget and still give us a tax relief. There may be a way to work this out through phasing in the tax relief.

Mr. LaFalce. I agree. But correct me if I am wrong, now.

If the January budget was roughly $20 billion in deficit, and if we are not going to close that budget by tax increases, that is, if we reject the import fee and the gasoline tax and other things, we have to reduce expenditures by $20 billion, and if we are going to reduce taxes by $25 billion, and, therefore, to reduce expenditures by another $25 billion, we are talking of a reduction in expenditures for approximately $45 billion to accomplish all those goals.

Do you believe that we can reduce our budgetary outlays by $45 billion?

Mr. Reardon. I do not know that $45 billion is the figure. People would disagree on that estimate.

I would point out that we have in the revenue estimates increases in taxation of $14.5 billion for the windfall profits tax, $10 to $12 billion for the oil import fee——

Mr. LaFalce. That is the law now.

Mr. Reardon. But the increases in taxation of over $36.5 billion are there. Through the process of inflation, and for other reasons it is in the budget. Why not turn around and begin to give the business sector the kind of tax relief it needs to encourage investment to increase efficiency with regard to the problem of energy-in-efficient equipment, aircraft, and so on?

Mr. LaFalce. I understand what you are saying. I just wanted to point out some problems along the way to what, I think, are our mutual goals.

You are calling for $25 billion. You specify how, also. You say H.R. 4646. Then you also say cut corporate tax rates. You also say reduce the tax bias against individual savers and investors.

I assume that when you talk about the tax bias, individual savers and investors, that you are talking about something akin to what we included in the windfall profits tax bill which was to exclude interest along with dividends and increase the amount, and so forth, as opposed to a cut in the personal income tax. Is that correct?

Mr. Reardon. Well, we recognize that there would probably be cuts in the personal income tax in any tax package.

Mr. LaFalce. Forget about the politics of it now.

Mr. Reardon. What we want to look at are some of the supply-side tax changes that could be accomplished to improve the state of the economy and appeal to incentives and improve individual behavior——

Mr. LaFalce. I am with you 100 percent, but what is a supply-side tax cut? You say that half of the $25 billion should be directed at reducing barriers to saving and investment.

But it seems to me that your total of $25 billion in the earlier paragraph is all directed toward reducing barriers to saving and investment.

So, it seems to me that on the one hand you are saying half of the $25 billion. But when you give the examples here, the examples are the totality of the $25 billion. I would like a clarification of what appears to be an inconsistency.

Mr. Reardon. I suppose the fact that it may appear to be an inconsistency depends on the estimates of the dollar impact of the various kinds of tax relief.

But we meant for half of the $25 billion, or whatever the magnitude of the tax relief, to go to business.

I just might make one further point about savings. One of the reasons——

Mr. LaFalce. So, when you say half for savings and investments, you do not really mean half of savings and investments. You mean half of business and the other half can go to individuals, but it ought to be the type of tax which encourages savings and investments for the individuals?

Mr. Reardon. Not necessarily. Individual personal income tax cuts could be in the package.

With regard to saving, it is just foolish for people to save with the inflation rate at, say, 15 percent in 1980 and the marginal tax rates at, say, 20 percent to 50 percent. Why should one save? Why not simply put one's money into durable goods or into any kind of spending?

This is the kind of situation which good tax policy could correct.

Mr. LaFalce. Mr. Reardon, I believe you are an economist; right?

Mr. Reardon. Yes.

Mr. LaFalce. I hear so much talk, which I think is loose talk, about the demand-side economics and the supply-side economics as if it is something new. I heard of the law of supply and demand a long time ago.

As I read the Wall Street Journal today, which has a national reputation, it seems to me they are a bit confused. They constantly talk about supply-side economics, which I think is clearly needed. But they also talk and promote to propagandize in favor of across-the-board income tax cuts as if the primary effect of that is going to be stimulation of supply.

Well, based on my understanding of economics, and based upon individuals I read who I respect, such as Herbert Stein, the former Chairman of the Council of Economic Advisors under Presidents Nixon and Ford, across-the-board income tax cuts are pure Keynesian economics, pure stimulation of aggregate demand and inflationary in nature.

I should not say pure, but overwhelmingly.

If we are going to be talking supply-side economics, we ought to be talking about capital cost recovery bill or variations thereof. We ought to be talking about exclusion of dividends. We ought to be talking about the reinvestment of capital gains into small businesses with the referral of taxation, and so forth.

That is supply economics, as I understand it. Could you comment on that?

Mr. **Reardon**. I would enjoy commenting on that.

If the tax relief is designed to stimulate demand, if it is to be $50 return to every family across the country, or if it is aimed——

Mr. **LaFalce**. Let us say a 10-percent across-the-board income tax cut.

Mr. **Reardon**. If the purpose of that tax cut is to stimulate the demand and to bring the economy up to something like "high employment"——

Mr. **LaFalce**. I am concerned about the effect.

Mr. **Reardon**. There is a macroeconomic effect, as you mentioned. But there is another effect, and that is to give individuals back the money that they have earned and reduce the role of Government in the economy and reduce the role of the private economy.

That is supply-side economics. To let the——

Mr. **LaFalce**. Herb Stein says that would take 33 years. I retracted the word pure demand and I say overwhelming demand side.

Would not the effect of a 10-percent across-the-board income tax cut be overwhelmingly to stimulate aggregate demand, whether or not that was its purpose?

Mr. **Reardon**. Well, one effect would be to stimulate demand. But on the other hand the tax reduction is on the marginal income where the rate is high for everyone—over 50 percent for some people——

Mr. **LaFalce**. One effect? There are a lot of effects. I am talking about the overwhelming effect.

Mr. **Reardon**. That would be the short-term effect.

Mr. **LaFalce**. How long? Five years? Ten years?

Mr. **Reardon**. Well, short term I consider to be 1 to 2 years.

I think over a period of time we have increased the tax burden over a period of time on the individual. The total taxes to the Federal Government are well over 22 percent now. That is very high.

Why not just change that trend and begin to lower it? We are increasing the personal tax burden on the individual under the so-called supply-side economics, which I agree is not at all new.

This reduces the incentive to work. It reduces the incentive to save, and it is inefficient because individuals, through private capital markets and through purchases in the consumer sector, are much better judges of how to dispose of their money.

Mr. LaFalce. Mr. Reardon, one of the recommendations you make is that we support the retroactive freeze on Federal employment resulting in a reduction in force through attrition through the calendar year, in order to keep fiscal year 1980 outlays lower. I support that.

However, in supporting that I also am cognizant of the fact that the number of Federal civilian employees per 10,000 population within the United States of America, has decreased over the past 30 years.

So, if you look to the number of Federal civilian employees per 10,000 population in 1947, you will see it was 151. You see that in the year 1978 the number of Federal civilian employees per 10,000 population was 132.

So, there has been an actual decrease in percentage terms of the total U.S. workforce from 3.37 percent to 2.91 percent over the past 30 years.

While I support the efforts to put a moratorium on the number of Federal employees, I think that if we are going to be fair in our representations to the American public, we have to present the facts.

In percentage terms based upon service to the population, which has grown, we have had a decrease in Federal employment.

Mr. Reardon. Well, I think what we are looking for are ways for the Federal Government to get spending under control immediately in 1980 without any great harm to services.

The number of Federal employees, of course, does not begin to measure the impact of the Federal Government on the economy. For example, we have tied loans to States and localities and the Federal Government influence has increased rapidly there.

Many jobs in Washington for the Federal Government are contracted out. Therefore, the Federal Government, in its total impact, has grown rapidly, not to mention guarantees and regulation, and so on.

So, this is just one little opportunity for savings of a large number of opportunities.

Mr. LaFalce. Mr. Reardon, what is the position of the Chamber of Commerce with regard to the indebtedness that exists in our society? The actions of the Federal Reserve, in large part, have been initiated because of the perception of the consumers' tendency in our society, the consumption tendency, the indebtedness.

Yet, as I look at the figures of debt as a percentage of GNP, I see that in 1960 the Government debt as a percentage of GNP, was 61 percent and using every 5 years, it decreased to 53 percent, and then decreased to 46 percent, and then to 44 percent. In 1979 it decreased to 41 percent.

So, we have had a decrease in Government debt as a percentage of GNP from 61 percent to 41 percent. But at the same time we look at the private sector.

In 1960, the private sector debt—and by that I mean both business and household—as a percentage of GNP was 83 percent. Then it increased to 94 percent, and then 99 percent. Then it increased to 105 percent. In 1979 it was 110 percent.

So, Government debt, as a percentage of GNP, has decreased from 61 percent to 41 percent, and private debt—meaning business and households—has increased from 83 percent to 110 percent.

I wonder if you would comment on that as a phenomenon within our society?

Mr. REARDON. I would be glad to comment on that.

I think that, insofar as some of that private debt is excessive, it is a result of Government policy. Government policies take away the incentive to save, for example, which almost forces people to use their income as rapidly as it comes in and take on, perhaps, more debt than they should and perhaps save in the form of durable goods rather than saving in financial instruments. If they had saved through using financial instruments, the money could have gone through the capital markets into investments in a more effective way. So, Government is responsible in this way for there being insufficient investment in new productive capacity.

Second, I think that Federal debt is substantially different from private debt. Much of that Federal debt is incurred for the purpose of short-term transfers of income, whereas private debt is a good thing in that it enables us to invest to develop means of production, to build homes, residences of all kinds, multiunit and single unit, to do the things over the long-term that need to be done by spending money today.

So, there is a substantive difference between private debt and public debt. Much of the public debt is simply long-term borrowing for short-term purposes.

Mr. LAFALCE. Does the Federal Government have a capital construction budget?

Mr. REARDON. I know there has been a lot of debate about the capital budget over the years. I do not think that it has, but I am not abreast of that.

Mr. LAFALCE. We do not know whether it does or does not. So, if we were to have a capital construction budget, would not the Federal Government's budget for operational expenditures actually have been in surplus over the past number of years?

Mr. REARDON. I really cannot answer that.

Mr. LAFALCE. You make the statement that 76 percent of the budget is deemed to be uncontrollable due to automatic escalation factors.

Mr. REARDON. Well, we did not mean to limit it to automatic escalation factors.

Mr. LAFALCE. What percentage of the budget is accounted for by automated escalators? Why would you have——

Mr. REARDON. Automated escalators are just one part of this.

Mr. LAFALCE. What is the other part of the uncontrollable budget?

Mr. REARDON. The whole entitlements portion of the budget is essentially deemed to be—for example, no one is trying to get into it this year.

Mr. LAFALCE. I understand.

Mr. REARDON. The long-term contracts, obligations over a number of years which have to be met are uncontrollable in the context of the budget process itself.

Mr. LAFALCE. My point is this. You have said we should move the historical control of the entire budget by changing legislation that allows for automatic escalation.

Mr. REARDON. That is one thing.

Mr. LAFALCE. I agree with that. Nobody has had the courage thus far to come out and do that, not the Senate Budget Committee, the House Budget Committee, or the President.

Yet, I think all would like to. I think it is a question of political courage.

Has the Chamber of Commerce publicly come out for this as a Chamber of Commerce position?

Mr. REARDON. Yes; we have.

Mr. LAFALCE. Can you explain to me how you would accomplish this? Would you do this simply by reducing the entitlement or would you redefine the CPI?

Mr. REARDON. Well, with respect to the benefits programs which are indexed to the CPI, it seems that since the CPI now overstates inflation, then those programs are being indexed upward at a rate which the Congress did not intend for them.

Mr. LAFALCE. I understand that.

My question is: Have you come out with the specific redefinition of the CPI and suggested that this is what you should use?

Mr. REARDON. We have not come out with a specific redefinition.

We believe the whole issue should be studied. The personal consumption expenditures (PCE) portion of the gross national product deflator is a better estimate of inflation than the CPI. It is about 3 percentage points under the CPI.

I think with respect to incomes, transfer incomes, which are indexed, that an increase in accordance with perhaps the increase of the wage rate, or the earnings index, would be more appropriate than the CPI.

That is one option.

Mr. LAFALCE. I have one last question.

I am often troubled because when I look at the rate of inflation in the United States I say: "Hey, wait a minute; we are using the CPI as the criterion for determining inflation." I have problems with that. Those problems are exacerbated when we have the automated escalator clause tied to what I perceive as to be an erroneous indicator of inflation.

But then I also find it helpful to look at the inflation rates of other countries for guidance as to policies that we should enact.

But I wonder what criteria these other countries are using to determine what their rate of inflation is. I am wondering whether, in the past, when I make comparisons between the U.S. rate of inflation and Germany or Japan or Argentina, I have been comparing apples and oranges or apples and apples.

Can you help me?

Mr. REARDON. I suspect that to some extent you have in that the bundle of goods that goes into their indices is not down the line in accordance with the bundle of goods that goes to our index and the way those goods are weighted.

With respect to housing, for example, it is surely different. But frankly I have not done a detailed comparative study. We do know from the indexes that inflation is lower in West Germany than it is here and that it is higher in Argentina.

Mr. **LaFalce.** I would be interested in anything the chamber has on that.

Mr. **Reardon.** Yes.

Mr. **LaFalce.** I want to thank you for your testimony. I think it has been quite enlightening. Thank you.

At this time I would like to call both the National Small Business Association, represented by Mr. Walter Paul, president of the Queen City Barrel Co. in Cincinnati, Ohio, and the Citibank Corp., represented by Mr. Anthony Dellomo, vice president for community business services.

Mr. Luken, do you want to make any comments?

Mr. **Luken.** Thank you, Mr. Chairman.

I am very pleased to introduce Mr. Walter Paul to the subcommittee. He is an eminent citizen of Cincinnati and in the economic community of Cincinnati.

He has been president of the Queen City Barrel Co. for many years. He is a very active participant in the life of the Queen City of the West. I cannot say enough for him.

I will not try to embellish this. I am just proud to introduce him. I am glad that the subcommittee has invited him. I think he is a very good representative of small business, having had long experience and being respected in this area.

So, I look forward to hearing from him.

Mr. **LaFalce.** Mr. Paul, please proceed.

TESTIMONY OF WALTER PAUL, PRESIDENT, QUEEN CITY BARREL CO., APPEARING ON BEHALF OF THE NATIONAL SMALL BUSINESS ASSOCIATION; ACCOMPANIED BY JEROME R. GULAN, LEGISLATIVE DIRECTOR, NSBA

Mr. **Paul.** Thank you, Mr. Chairman, and thank you, Mr. Luken.

Mr. Name is Walter Paul. I am president of the Queen City Barrel Co. in Cincinnati, Ohio.

I appear here today on behalf of the National Small Business Association, a multi-industry trade association representing approximately 50,000 small business firms nationwide.

Accompanying me is Jerome R. Gulan, legislative director of NSBA.

I am appearing here today to plead for the thousands of small firms that are facing the closing of their businesses because Federal regulatory agencies are pressing enforcement of rules and regulations at a time when we are unable to borrow the capital necessary to comply.

I urge a moratorium on deadlines being imposed by these agencies in order to preserve our businesses and retain our employees.

By way of background, I have been with the Queen City Barrel Co. for the past 40 years. Prior to entering the service in World War II, I served on the Reconditioning Industry Advisory Committee to the National Production Authority, and I was the only industry member of the National Defense Executive Reserve under Presidents Eisenhower, Kennedy, Johnson, and Nixon.

Our company was founded by my father 54 years ago and it reconditions and recycles approximately 700,000 steel drums each year. We employ approximately 145 people; 85 percent of which are minority.

We are considered one of the 10 largest companies in an industry of about 180 companies of which 95 percent are family owned.

The steel drum reconditioning industry in the United States reconditions and puts into reuse approximately 50 million 55-gallon steel drums annually. Reconditioning is an important resource and energy conserving function, in addition to performing a valuable economic function.

By reconditioning approximately 50 million drums a year, our industry saves the equivalent in energy of 1.8 billion gallons of oil. As for the conservation of steel, by reconditioning this quantity of drums annually, we save over 2 billion pounds, or 1 to 1.25 million tons of sheet metal.

It is almost unnecessary to spell out the obvious resultant conservation of natural resources. The coal, iron ore, manganese, sulfur, phosphorous, carbon, and other minerals and chemicals conserved by not manufacturing that 1 million tons of steel annually is a vital necessity to conservation of our natural resources.

Seventeen George Washington Bridges could be built with the steel that we conserve.

As for reducing solid waste pollution, if these drums were not picked up, reconditioned, and put back into commercial reuse, they would constitute a serious blight and a contributing factor to pollution of earth, air, and water.

Most drums contain a residue of their previous contents—oils, chemicals, paints, and so forth. Our industry acts as an unpaid collection system receiving all of these pollutants, treating the drums, cleaning the containers, and returning them to commercial reuse, and at the same time disposing of the residual sludge.

In my 40 years of experience in the reconditioning business, we always considered ourselves as a recession-proof industry. We even made a profit during the years of the Depression.

For the first time in my lifetime, we find that we are no longer recession proof. Our profits are down 95 percent over the last 10 months from the previous 12 months. We have found it impossible to both adhere to the President's wage and price guidelines and to maintain a profitable business.

Our only price increase in 1979 was on May 15 and was an 8.5- to 9-percent increase. Our only price increase in 1980 was on April 1 and was 9 to 9.5 percent.

Our employees' wages and salaries were increased approximately 10 percent in 1979 and working stockholders—my brother and myself—had reduced salaries of 7 percent in 1979.

In the past 10 months our costs have increased 10.8 percent; however, due to loss of volume of business of approximately 15 percent, costs increased an additional 8.7 percent.

Trucking costs are up 30 percent per unit due to fuel price increases of 80 percent. Paints are up 12.5 percent—interior coatings or linings for drums are up 18.5 percent.

Utilities—gas up 22 percent; electric up 5 percent. Replacement parts for drums, such as lids, up 9.8 percent; locking rings, up 9 percent; gaskets up 20.7 percent; plugs up 7.6 percent.

In the year ending April 30, 1979, we earned a substantial profit—a net of about 4 percent. In the first 10 months of the current year ending February 29, 1980, we have earned less than one-fourth percent net profit.

The last 3 months in particular have been a nightmare since we lost $173,000 for December, January, and February.

Regardless of what economists say, the reconditioning drum industry has been affected by a recession since July 1, 1979. In my opinion, our experience reflects that of most companies in our business.

Four years ago, in cooperation with the air pollution people, we were the first reconditioners in the United States to go to a 100-percent water-based paint. Water-based paints eliminate any toxic fumes from entering the air, but create a gray haze on certain days, depending on the atmospheric conditions, which the local pollution people term unsightly.

We were unable to find a cure for this problem as far as a state of the art anywhere. Last year at an international convention of reconditions, we discovered that the Germans had the same problem and had been unable to eliminate the haze.

We wanted to go back to rule 66 solvent-based paints which would have been a step backward as far as air pollution, but would have made us legal.

Instead, we cooperated and engineered a project whose cost was estimated at $135,000 last year—and there is a good chance that it will not work. This project is half completed.

Under Federal regulations we are not in violation with the gray haze as they have no opacity regulations on our sources. However, under Ohio EPA and county EPA regulations, we are in violation and have been denied a Federal permit. Such is the plight of small business.

Two years ago, after 5 years of research and spending $250,000 for outside engineering services, we came up with a plan to solve all our environment problems and recapture the energy from the burning of the waste left in the empty drums.

The plan was estimated to cost $2.7 million, which would have increased our production by only 10 percent. We could not justify the expenditure (1), because the net worth of the company was only $2 million, and, (2), because of the risk that our engineering might be wrong.

We then decided instead of trying to solve all problems at one time, we would go at it piecemeal and spend $200,000 per year so that we might survive.

We feel that our industry is in a recession and that, because of galloping inflation and loss of volume of business, it is impossible to comply with price guidelines and earn a profit.

It is impossible also to draw on any experience from the past as the present scenario is completely different from any we have experienced in my past 40 years in business.

Small business is now faced with a new cost problem with the raising of interest rates by the Federal Reserve Board.

If it is the intention of Government that we suffer a long and painful recession, small business must be strong financially in order to survive during a recession.

If others in small business, like myself, have been experiencing a negative cash flow during the past 10 months, and are faced with a prime rate that may reach 25 percent in the next 3 months, Government must be willing to call a moratorium on its regulatory agencies which insist that we meet deadlines and make large capital expenditures for nonproductive items, such as environmental controls, OSH requirements, and so forth.

The Federal Reserve says that it wants to discourage the obtaining of credit for nonproductive capital expenditures and yet other agencies of Government insist that we make them. Obviously, all branches of Government are not taking steps to deal with inflation.

Obviously, there is no national commitment to licking inflation. Unless a moratorium is called for on the regulatory agencies, a lot of small businessmen face bankruptcy.

The alternative, of course, would be to sell out to publicly owned companies which would lessen competition and increase concentrations of wealth, and consumer prices.

In testimony before Congressman Henry Nowak's Small Business Subcommittee, Frederick Schultz, Federal Reserve Vice Chairman, said: "Businesses, both large and small, will find that bank loans are more costly and less readily available."

He added that: "Without a reduction in inflationary expectations, we have no hope of lowering interest rates over the longer term. Such a reduction can only occur when businessmen and consumers become convinced that all branches of Government have taken the necessary—often painful—steps to deal with inflation."

A call for a moratorium cannot be delayed. No small business should be forced by a Government regulatory agency to make commitments for high interest rate credit when its cash flow is in a negative position.

You do not go out and buy a $100,000 house the day before you know you are going to lose your job. Rigorous enforcement of the mandatory regulations by the regulatory agencies will provide clean air and clean water for the hungry and unemployed.

Small business will be committing suicide by making nonproductive expenditures and financial commitments in the face of a recession, which for many of us is already here.

To summarize, the Federal Reserve insists upon increasing interest rates in order to discourage the obtaining of credit and has issued a directive of 16 items of guidelines for banks not to loan to companies for nonproductive items.

There is a great inconsistency in a Government policy which tells you not to borrow and a regulatory agency which forces you to borrow.

The Government should immediately call a moratorium on the deadlines which are being imposed on small business. All deadlines would be reimposed when cash flow, interest rates, and profits go back to normal.

If something is not done immediately, small business will come to a grinding halt.

For the information of the committee, we are attaching a policy recommendation previously submitted to the Board of Governors of the Federal Reserve System and a copy of a letter sent to the President requesting a moratorium on the implementation of Federal regulations for small business.

I ask that these be placed in the record at this time.

Mr. LaFalce. Without objection, so ordered.

[Policy recommendation and letter referred to above follow:]

A Policy Recommendation of the Small Business Community

Recognizing the serious dislocation that is already occurring in the small business community as higher interest rates necessitate the rationing of the availability of money and the role small business plays in assuring a competitive market place:

It is urged that immediate steps be taken by the Federal Reserve Board to establish a two-tier discount rate on federal funds to encourage additional availability of money through the banking system at interest rates which can be absorbed by small business and in adequate amounts to avoid a threatened extinction of many small business firms.

We envision a small business discount rate three points below the prevailing Fed discount rate.

Small business borrowers would certify in their application to their bank for funds that they are a small business as qualified under the SBA size standards and type of business regulations, and thus qualify for a lower small business rate for a level of borrowing equivalent to an amount borrowed in the previous period one year ago plus adjustment for the CPI. This would entitle the bank to loan funds at a rate three points below the prevailing prime plus any additional points charged the borrower in the prior one year ago period.

The bank would then use this certification as the basis for applying to the Fed for a lower discount rate for those funds that represent loan amounts to their small business customers.

As an example, if in the month of October the bank borrowed $10 million from the Federal Reserve and during that month $3 million of their funds were loaned to certified small business borrowers, then the Fed would issue a credit to the bank for 3 percent of $3 million divided by the appropriate pro rata days the money is used.

The concept of two-tiering interest rates for the small business community is not new; the uniqueness of this policy recommendation is the coupling of an incentive with a two-tier policy to insure its implementation by the banking community.

A precedent for the two-tier policy was the establishment, in 1973, of the Committee on Interest and Dividends (CID) under the Economic Stabilization Program. The CID announced a dual prime rate on April 16, 1973, to:

1. Hold down money costs imposed on mortgage borrowers and other low-powered loan applicants;

2. Prevent large business borrowers from absorbing an undue share of the lendable funds available through the banks. This would prevent large businesses from acquiring funds that otherwise would be available to small businesses, consumers, and home buyers.

The principle of a two tier rate for the small business community is founded in both logic and equity. The competition for dwindling money is an unequal contest when the small is pitted against the giant.

The economic conditions of 1979, both domestic and international, plus a change in the Federal Reserve policy from focusing on interest rates to focusing on growth of bank reserves, makes it mandatory that an incentive be provided to the banking community to insure the availability of funds to the small business community to increase productivity and to protect and provide jobs.

That is why we advocate the establishment of a two-tier discount rate for the banking community for their participation in a dual rate program.

We are heartened by Chairman Volcker's recent letter to major bankers urging them to take particular care that small businesses receive a reasonable share of available funds.

Submitted by: Lionel Kunst, Fabri-Quilt, Inc., North Kansas City, Mo.; Don J. DeBolt, Executive Director, Menswear Retailers of America, Washington, D.C.; Fred P. Schoenfeld, Select Brand Industries, Inc., Kansas City, Kans.; and John Lewis, President, National Small Business Association, Washington, D.C.

National Small Business Association,
Washington, D.C., March 28, 1980.

The President,
White House, Washington, D.C.

Mr. President: The National Small Business Association has followed the progress of your Regulatory Council and is extremely heartened by the work being done to reduce regulatory burdens on the small business community.

However, the shortage of capital and current high interest rates have caused a severe problem for small firms which should be brought to your attention. In the past few weeks we have received a number of calls from small business owners relating to their inability to comply with mandated federal standards because of being unable to obtain capital to purchase equipment or make structural changes as required by law. Several of the firms have been threatened with closings by the federal agencies involved.

Because of the tight money problem, we urge you to declare a moratorium on the enforcement of regulations and implementation of standards where the public health and safety is not involved and the lack of capital for small business is a factor.

Small businesses have given every indication of wishing to comply with existing laws and regulations. If the regulatory agencies pursue their present course, many of these firms will be forced to go out of business with the resultant loss of jobs and reduction in economic activity.

We urge your immediate consideration of this request.

Sincerely,

Herbert Liebenson, *President.*

Mr. Paul. Thank you for the opportunity to be heard.

Mr. LaFalce. Thank you.

I know Mr. Luken has a time constraint. I know he wants to ask Mr. Paul some questions, so I will call upon Mr. Luken at this time.

Mr. Luken. Thank you, Mr. Chairman.

Mr. Paul, as you stated, you have been in business for 40 years. I believe the company existed before that.

Mr. Paul. Yes; 54 years.

Mr. Luken. I think your company might be acknowledged as a leader in the field, an energy-related field. That means that you have practically all of the problems that exist.

Your energy problems bring about further regulations. You have problems with the Federal EPA and the State EPA. They seem to be working at cross purposes in your particular situation.

You are telling us that these are the most unsettling times that you have experienced. Is that basically what you are saying in the 40 years you have been in business?

Mr. Paul. Yes; because I have never seen a negative cash flow in the reconditioning business in all the years I have been in the business.

That may be due to a tactical error on my part. Perhaps I did not increase my prices often enough in the last 10 months. Possibly if I increased prices 4 or 5 months ago, I would not have had the loss that I had over the last 3 months.

We are faced with business being 15 percent off right now. Frankly, the economic news in Cincinnati in the past week has been very sour. I have heard more bad news in the past week than I have heard in a long time.

I feel that we have been in a recession since July 1 of last year.

Mr. Luken. The recession usually does not hit Cincinnati with the same sharpness that it hits other areas.

Mr. Paul. In the past that has been true.

It is a mixed bag. You cannot really tell. There are some companies that are working three shifts every day of the week. But there are other people working 30 hours a week.

Mr. Luken. The prosperity of General Electric in their engine division has served to offset that by employing several thousand more people. It does offset a lot of smaller losses in various industries.

The problems of financing now are really compounding the situation so far as you are concerned?

Mr. Paul. The high cost of financing, I think, is too much for small business to assume at this time. If the recession is going to last a year and a half, I think we should have a moratorium for a year and a half.

Mr. Luken. So, your proposal and the proposal of the National Small Business Association, which is attached to your statement, is that the moratorium would exist during the period of excessive cost of financing.

When the indicia of the recession is still present, that is the proposal?

Mr. Paul. Right.

Mr. Luken. Are you finding acceptance to this idea? Do you think it is a practical one?

Mr. Paul. Well, whether it is practical or not, I do not know. To me, it is practical.

I feel if it is not going to happen, we are going to get gobbled up by big business. We have been told several times in the past 4 or 5 years in our industry that with all the costs that we have so far as the environmental costs are concerned—and we are labor intensive and energy intensive and capital intensive—we have been told that we are going to have to sell out to a publicly held company if we are going to continue to exist.

We were told by the industry consultant of the Interstate and Foreign Commerce Committee, who visited our plant about 3 years ago, and predicted by 1983 we would probably have to be coupled with someone much larger than ourselves in order to survive.

Mr. Luken. They would not have foregone the price increases that you would. You were part of a larger conglomerate. The price increases would have been assessed and inflation would have been increased correspondingly.

Mr. Paul. I am certain.

Mr. Luken. Your problems are principally environmental, though. If it were not practical to put in a moratorium on all regulatory agencies, that is pretty broad.

Mr. Paul. We have a neighbor. I think it is right around the corner. I think it is Consolidated Metals. He told me that his interest is two-thirds of his profit at the moment. He has huge expenditures to make for OSHA which he cannot afford to make at the moment.

I am speaking on behalf of all small business. All our problems are not the same. When you have to go to the bank and borrow at 22 percent to 25 percent, it is ridiculous. Most small business does not earn over 2 percent, 3 percent, or 4 percent.

You add another 22-percent interest on top of that, and you have a big debt there to pay. You would be lucky to pay the interest, let alone the principal.

Mr. Luken. But your particular problems of regulation are environmental.

Mr. Paul. That is correct.

Mr. Luken. You do not have the OSHA problems, at least not any acute problems.

Mr. Paul. That is correct.

Mr. Luken. It is the financing there and the carrying out of these contradictory orders that you have from the U.S. EPA and the Ohio EPA. That is the problem.

I think as the Small Business Committee we should take a serious look at it and look at the other regulations. Certainly I think there is room to consider with regard to environmental problems, such as yours and under certain conditions I think there should be a feasibility.

Obviously we are going to have to take a broader look to just what it would amount to. I suppose when you are talking about regulations, you would be included in the Internal Revenue Service.

It is pretty broad. The National Small Business Association could help us to refine it and establish the conditions. We would then be moving along.

But certainly your testimony, which I can vouch for, has many people in the Cincinnati community which can vouch for the accuracy of your statement with regard to your company because it is a well-known company, though not a large company, and its activities, reliability, integrity, and financial stability are well known.

Therefore, any suggestions you would make, I think, should be considered as validated by that history that you have had.

We appreciate your coming. So far as I am concerned, I am honored and proud that you are representative of Cincinnati and its small business before this committee and Congress.

Mr. LaFalce. Thank you, Mr. Luken.

I have no further questions, Mr. Paul. You are free to go at this point.

Mr. Dellomo is the vice president of Citibank.

Welcome.

You may proceed.

TESTIMONY OF ANTHONY E. DELLOMO, VICE PRESIDENT, CITIBANK

Mr. Dellomo. Thank you, Mr. Chairman.

First of all, I would like to thank you for the invitation and also make mention your letter of April 11 has finally arrived.

Basically, I am vice president in a small business lending unit with the bank in the Metropolitan New York area. My unit is one of six that Citibank has formulated for small businesses.

Small businesses we so define as companies under $10 million in sales.

Usually the loans to these companies are in the realm of $25,000 to $100,000 in size. We also attempt to look at larger loans, or even smaller loans, depending upon the need of those companies.

The six regions that have community business teams at this time have over $300 million in loans to small businesses.

We basically have account offices on every small business team that are specifically trained against the small business market and they are totally devoted to lending in the small business market.

At the same time, all of the officers and myself included are certified lenders under a special SBA program that allows us a very quick turnaround time, and to authorize loans under $250,000. That turnaround time for the SBA used to be 2 months to 3 months to have a loan processed. Right now we can probably do it in 6 or 7 business days to help the small businessman.

Aside from the SBA program, if any of the community business teams turn down a loan strictly for credit reasons, we have alternative places in the bank that will review the request again.

One happens to be the Central Urban Services Department. They look at the loans from a standpoint of major employment that impacts the community so far as a specific need is concerned.

That is, therefore, a stopgap for small businesses that may be overleveraged or have other difficulties and normally would not pass our credit criteria.

Believe it or not, loan demand for the last several years has been very strong, and we have averaged 30-percent growth per annum over the last 3 years.

In the small business community we have seen very little dropoff in this loan demand over the last 6 to 9 months.

To date there has been very little delinquency in the small business loan portfolio that we maintain in the bank. We have noticed that these delinquencies may be masked by payables being extended to the trade.

We also see that there has been a lot of note discounting going on between companies, and while we have no delinquency problems at this time in the small business community, it looks as if it is being financed in different ways, or kept current.

Our experience, however, suggests that the small business community, while they are very sensitive to rates, their survival is more dependent on the need for liquidity. That a bank is willing and able to make loans to them at any given time.

With the risk asset growth constraints on us at this period, we have one thing to lean back on as a stopgap for that. Because we have such large corporate customers, we can take those funds and segment them from that market and reallocate that to the smaller business market.

So, at this point in time Citibank has no specific constraints in lending to the small business market. We are not now holding back credit to our customers.

Mr. LaFalce. Mr. Dellomo, I have to interrupt you for a second. We have been going since 9 o'clock this morning. I was hoping that we could adjourn about 11:30 a.m. I have rescheduled us to meet at 1 o'clock. I have a 12:30 p.m. commitment, which I must keep.

But I do want to ask you a few questions before we adjourn.

First of all, and most importantly, in the testimony of the NFIB, they lamented the fact that there was such little data regarding loan practices of our financial institutions vis-a-vis different sectors of our economy, especially the small business sector.

They believe that more data should be available in order to make certain types of determinations.

I have two questions.

No. 1, do you have any data as to the number and amount of your loans on a small business as opposed to large business bases?

If not, how difficult would it be to accumulate such data, at least prospectively?

Mr. Dellomo. So long as it stays within the size of companies below $10 million in sales, I think that data could be made available. I do have some data with me today that talks to the issue that 40 percent of the number of loans in our entire small business portfolio are under $25,000 in size.

Mr. LaFalce. What is your entire small business portfolio as a percentage of the number of loans? Then what is the percentage as to the total amount of loans?

Mr. Dellomo. I would think in the realm of 6,000 to 7,000 loans of approximately 20,000 total loans are under $25,000 in size, many of which—and this data is available and we have supplied it to the city of New York previously—are under $15,000 in size.

We have developed specific products, both fixed-rate loans and small lines of credit for the small business community. This is where those loans are.

Mr. LaFalce. One of the recommendations of the NFIB is that since there are so few financing alternatives, that what we should do is permit financial institutions that hitherto have been unable to give business loans, to engage in loans to the business community.

By that they mean greater powers for competing financial institutions.

Would you care to comment on that?

Mr. Dellomo. I would comment that on an annual basis we have been growing our portfolio approximately 30 percent per year. That does not appear to be that there are not alternative financing to the small businessmen. As a matter of fact, in particular we have created several products within small business lending and have worked on programs with the Government under SBA certification programs to make funds available.

So, I really do not see where there is a limitation or a lack of ability for the banks to make those types of loans.

Mr. LaFalce. I also raised the question as to whether the existence of the McFadden Act might be deleterious to increased competition among financial institutions, and, thereby, adversely impact the small business community.

Do you care to comment on that now?

Mr. Dellomo. I would rather refrain from commenting on that because the bank has made some statements on that previously.

Mr. LaFalce. Based on the testimony of the NFIB, they indicated that the only data that exists of which they are aware was data collected by the Federal Reserve in 1955 and 1957, which was studied by Silber and Polakoff, demonstrating that during tight money periods banks favored large business and reduced the amount of money of the small business loans.

Are you aware of the Silber and Polakoff study?

Mr. Dellomo. I am not particularly aware of their study, but in 1974 and 1975 I was in Citibank as a commercial lending officer also.

Quite frankly, one of the limitations we have not looked at that could have caused part of that effect was the two-tier rate for small businesses.

Mr. LaFalce. That was something that was done voluntarily, was it not, by Citibank?

Mr. Dellomo. No; that was not a voluntary two-tier rate at that time, to the best of my knowledge.

Mr. LaFalce. Who imposed a mandatory two-tier rate?

Mr. Dellomo. I believe it was a Government mandatory rule. But I am not positive on that. I know all banks in New York City went to a two-tier rate. That would be——

Mr. LaFalce. I do not think it was mandatory.

Mr. Dellomo. I am not sure, but I believe it was.

Mr. LaFalce. I am going to have to adjourn these hearings.

You are excused.

We will come back at approximately 1 o'clock. I may be about 5 minutes late.

Afternoon Session

Mr. LaFalce. The subcommittee will be in order.

I want to apologize for being late. We did not adjourn until about 12:35 from the meeting that we began at 9 o'clock this morning. I just could not get back here any earlier.

We have with us this afternoon Mr. Milton Stewart, the Chief Counsel of the Office of Advocacy. Mr. Stewart requested that he be accompanied at today's presentation by a number of individuals from the small business sector with whom he has been working over the past number of months. I think in large part it has been in connection with the White House Conference on Small Business. Is that correct, Mr. Stewart?

Mr. Stewart. About half of these folks.

Mr. LaFalce. It is unique to have such a large number accompany one witness; but, since it was the Chief Counsel for Advocacy of SBA, I wanted to give him as much latitude as is possible.

Also, I have some time constraints. I can only go to 3 o'clock. I have some appointments. And I have other people. I have the Department of Housing and Urban Development, and I have the Council on Wage and Price Stability. So, do you think that somehow we can go about 40 minutes perhaps until maybe 5 after 2? That will enable us to have about 20 minutes with the other two.

Mr. Stewart. We will be happy to oblige you, Mr. Chairman.

TESTIMONY OF MILTON STEWART, CHIEF COUNSEL, OFFICE OF ADVOCACY, SMALL BUSINESS ADMINISTRATION; ACCOMPANIED BY PAUL L. MACLER, PRESIDENT, MACLER INDUSTRIES, INC., FRIENDSHIP, N.Y.; RON PIERCY, PRESIDENT, A-D-E LUMBER SUPPLY CO., INC., KANSAS CITY, MO.; SANTOS T. ABRILZ, JR., PRESIDENT, APOCA INDUSTRIES, INC., DEER PARK, N.Y.; ROBERT CARR, PRESIDENT, SEACOR, CHERRY HILL, N.J.; SAM A. PASCH, PRESIDENT, MEN'S WEAR RETAILER APPAREL ASSOCIATION OF AMERICA, AND PRESIDENT, POLACHECK'S, MILWAUKEE, WIS.; AND HAROLD STONE, ABA SMALL BUSINESS COMMITTEE

Mr. Stewart. Mr. Chairman, from our standpoint, we would appreciate it if you would view this as the first part of SBA's response to your invitation. We will be back by agreement with your staff on May 13 and formally present what we do not have today, which is an orderly statement on the problems of small business with inflation immediately and long term.

Mr. **LaFalce.** I think it is imperative. I do not know if you had an opportunity to read my opening statement.

Mr. **Stewart.** I have, sir.

Mr. **LaFalce.** I think it is imperative to develop a national strategy to assist the small business community to cope with inflation.

Certainly we must combat inflation. The small business sector will be the beneficiaries of any success we are able to have in the general fight against inflation. But we ought not to fool ourselves nor delude ourselves by thinking that that is going to happen easily or overnight. There will be severe strains and dislocations in that process.

It would seem to me imperative that this administration recognize that and come up with some strategy to cope with that. That is what I am seeking, and that is the purpose of these hearings. That is the reason to permit you to work your will, which I think coincides with mine, on the administration to delay in the format presentation by you for about 2 weeks or so.

Mr. **Stewart.** We appreciate very much your consideration. Let me try to set a model for these gentlemen. I think you will find that they are perfectly able to present themselves and their points of view very quickly. If we can start at this end of the table with a fellow New Yorker of ours from upstate New York, this is Paul Macler. Paul, would you tell the chairman of the committee who you are? If you could just give us in 2, 3, or 4 minutes what it is you think is critical about the present situation.

Mr. **Macler.** My name is Paul Macler. I am president of Macler Industries, Inc. We employ about 100 people. We are a metal casting facility. We are located in the southern tier of New York State.

Mr. **LaFalce.** Are you in Congressman Lundine's district?

Mr. **Macler.** Yes.

Mr. **LaFalce.** In my judgment, he is one of the finest Congressmen in Washington.

Mr. **Macler.** I had an opportunity to speak with him on this this morning as well.

Our industry is a member of one of the Nation's most basic industries. There are 4,400 plants in this country which produce about 19 million tons of castings, about $21 billion a year. The fact of the matter is that over 80 percent of the plants in our industry employ less than 100 people. So, we find we are particularly impacted by the present rates of inflation and the high cost of money.

As I am sure you are all aware, small businesses are nearly 10 million strong and make up 95 percent of the businesses in the country today. They employ about 58 percent of our Nation's work force.

I believe that the importance of small business to our country speaks for itself. Small business is the backbone of the free enterprise system. It is imperative that we closely watch the impact of excessive inflation, high interest rates, and the lack of short- and long-term money to insure the future strong posture of small business in our Nation.

We have been reviewing the present status of our economy and its impact on the small business community. Dun & Bradstreet is quoted as saying that the failure rate of small businesses in our country has increased some 25 percent between 1978 and 1979. This rate is presently on the rise.

If we look at the quick ratio analysis of companies—that is the holding of cash and other assets readily convertible into cash as a percentage of debts due—in the worst part of our last recession in 1974, that ratio was 42 percent. In 1976 it raised to 54.4. Today we are at 42.5 percent. Within the next few months, the quick ratio will drop lower than the lowest point in the last recession, and it will equal the harshest downturn since the 1930's.

This change has developed principally——

Mr. LaFalce. Mr. Macler, that is very important. Would you repeat those statistics?

Mr. Stewart. Tell me again.

Mr. Macler. In 1974 the quick ratio percentage was 42 percent. In——

Mr. LaFalce. What was that ratio again?

Mr. Macler. The ratio of cash and assets readily convertible to cash as a percentage of debts due and payable within a 12-month period.

Mr. Stewart. That is a term that every loan officer in the country is trained to watch, Mr. Chairman, by the Robert Morris Associates and the educational devices in the institutions.

Mr. LaFalce. It was 42 percent in 1974. All right.

Mr. Macler. In 1976, Mr. Chairman, that ratio improved to 54.4. In 1979, presently, it is at 42.5 percent. It is estimated that in the next few months that this ratio will drop below the 42 percent low point of 1974, which will be the worst downturn we have seen since the 1930's.

Mr. LaFalce. Do you know what it was in the 1930's?

Mr. Macler. I do not have that information presently with me, but I can get that for you.

Mr. LaFalce. That would be very interesting.

What is the source of your data, Mr. Macler?

Mr. Macler. This is estimated by Goldman, Sachs & Co., which is a New York securities company.

Mr. LaFalce. Yes; I believe Mr. Kaufman is a member of Goldman & Sachs.

Mr. Stewart. He is.

Mr. LaFalce. By the way, Mr. Bereuter, why do we not adopt the more informal method; OK? Thank you.

Mr. Macler. In looking at where these changes have occurred in the iron and steel industry, of which I am a member, the ratio in 1974 was 44 percent. It is my understanding from the same information series that has dropped to some 19 percent.

Mr. LaFalce. Wow.

Mr. Macler. The automobile industry has dropped from 17 to 15 percent.

Mr. LaFalce. From what to what?

Mr. Macler. Seventeen percent in 1974, in the worst-case analysis, to 15 percent today.

In the rubber industry it has changed from 17 percent in 1974 to 11 percent.

We are finding that most small businesses are in a cash shortage position. It has been difficult to generate the kinds of credit needed for many small businesses to bridge this gap. Some major efforts to help this situation need to be made very soon, not longer than 30 or 60 days, so that we can provide the small business community with the proper cash flow to continue in business.

The banks appear either not to understand or not to be following fully the exemptions as we understand them on the 6- to 9-percent relationships as set up by the Federal Reserve Board.

The rates in my case approach 2 percent above prime instead of being at price or below and the discount, as we understand it should exist.

Other areas in which small business are suffering include the long-term debt area. In our case, we are faced with an expenditure of a quarter of a million dollars this year to meet the demands of Federal regulations. If we borrow that money, it would have to be borrowed at about 2 percent above prime. That is assuming we can get it. And we would have to pay it back in 5 years.

A large corporation probably would be able to float the same loan at a rate of 9.38 percent, which is the average corporate bond rate, and with a payback period of some 20 years.

So, if we look at the cash flow requirements for a business our size, our first year interest cost would be some $55,000. A large business would have $23,450. Our principal payments would be $50,000; a large corporation, $12,500. What does this say? It says principally in the first year we have to generate a cash flow of $105,000, and the large business would only have to generate a cash flow of $35,950.

We would have to pay 2.9 times more interest and principal in the first year than a large corporation. I hope that this example clearly demonstrates the burden that small business must bear in the capital market.

Incidentally, this equipment does not add any profits to our firm. In fact, it will add considerable costs of operation.

In addition, we face challenges to make change to meet the technological changes and improve productivity and manufacturing methods so that we can produce products that are more competitive in the marketplace and allow us to meet the challenge of foreign competition and large corporations. We first must meet the immediate problems, and that is short-term money available to the small businessperson.

We must then look at the cost of compliance for small businesses to meet the Federal and State regulations. This should include the ability to provide funds at reasonable rates and with reasonable payback periods. These programs should further provide for solutions which are technologically and economically feasible.

In addition, we should seriously consider programs which will encourage reasonable fiscal policy to provide for reinvestment in our plants and modernization. This may include but not be limited to accelerated depreciation and improvements in investment tax credits.

The small business community is willing and committed to shoulder the responsibility to contribute to our country's future. We are, however, at a very important threshold. The handling of the economic situation at this point is critical to the future of small business in our country. In the last 2 weeks, we have seen a perceptive decrease nationally in orders in our industry.

An industry such as ours, a casting plant, supports the automotive, the powerplant industry, and housing. We have experienced this downturn months ago.

I support the tax provisions of 1053 and H.R. 4646 that will allow a 1-year writeoff, accelerated depreciation on air pollution control equipment. It would allow a 10-year writeoff on buildings, 5 years on equipment in general, and 3 years in automobiles. It is felt by Norman B. Ture, an economist, that 450,000 new jobs would be generated in the next 5-year period if this bill were to be passed.

We support energy conservation and technology. I am against incremental pricing on natural gas. This would be highly inflationary on our industry and highly inflationary in my particular plant, which is a heavy user of gas in the production of its products.

We are concerned about the environmental areas, but we ask for technological and economically feasible solutions to exist before regulations are implemented.

I should say also, sir, that our industry spends approximately 30 percent of its capital investment each year in environmental areas. In a small business case like ours, it runs more like 50 percent.

I want to thank you for the time and interest.

Mr. LaFalce. Thank you.

Mr. Stewart. Mr. Chairman, if I may, I might suggest we go next to the only nonsmall businessperson we have got, the chairman of the American Bar Association Small Business Committee, a very distinguished member of our association, Harold Stone of Gatlinburg, Tenn.

Mr. LaFalce. He is not on the list; is he?

Mr. Stewart. He is a latecomer, joined us today.

Mr. LaFalce. OK. Before we do that, I have just a quick question, which maybe you can answer or you can, Mr. Macler. We are talking about the advantage of big business by being able to go to the bond market.

Is there any program that we could develop that could enable groups of small businesses to pool their resources to go to the bond market? You know, we have something like that for pollution. We guarantee tax exempts, which I really do not favor conceptually. But is there any way that we can develop a program that would facilitate grouping together for tax exempts or grouping together for taxable bonds with guarantees by SBA? Is that under consideration? Is it feasible? Would it be helpful?

Mr. Stewart. Let me try to answer. First of all, I would like to reserve and come back and answer a little more fully.

In a sense, that is what the bulk of SBA lending is right now.

Mr. LaFalce. That is on an individual, ad hoc basis, and then we——

Mr. Stewart. The secondary market represents a takeout.

Mr. LaFalce. Yes.

Mr. Stewart. We are functioning as a broker between the banks on the one hand and small business on the one hand and the secondary market on the other. We are pooling small business loans. They are being fed into the secondary market.

Mr. LaFalce. Yes; but we are guaranteeing an interest rate that is a couple of percentage points above prime. If we were able to go to the bond market directly, we would have a much lower interest rate; and that is crucial. So, there is a big difference there.

Mr. STEWART. I will try to come back with a more orderly response next time.

Mr. LAFALCE. OK. I have one more quick one.

If we do not get that conference report passed fast, I am going to shake loose section 503.

Mr. STEWART. Are we talking about S. 918?

Mr. LAFALCE. Right.

How helpful would that be? And how quickly could SBA, would SBA implement section 503? And would you consider the implementation of section 503 as part of a national strategy?

Mr. STEWART. Can I embarrassingly confess I cannot remember what 503 is.

Mr. LAFALCE. I am sorry. That permits a local development corporation to float bonds that could be guaranteed by SBA so long as a percentage of the loan was first underwritten by a private financial institution without a guarantee to preserve the integrity of the loan.

Mr. STEWART. I can only answer for myself. As soon as, hopefully, that particular provision or the bill as a whole—which is, of course, the agency's position—passes, you may count on the most expeditious administration we can give you.

Mr. LAFALCE. I have been waiting for the conference report for a long time. If we cannot do something, it seems to me the imperatives and crisis we are confronting would demand that we break that loose and get it passed and implemented.

I can think of a lot of arguments against it, even though it is my bill; but we have got to come up with something.

Mr. STEWART. I do not think you will find any disagreement here. Harold?

Mr. STONE. Mr. Chairman, I am Harold Stone from Knoxville, Tenn. I am a practicing attorney. Mr. Stewart called me just recently and asked me to take a look around my area at the effect inflation and high interest rates were having on people I represent.

My firm generally represents a variety of small business, financial institutions, and small banks. Therefore, I do have some insight into what is happening today, this week in east Tennessee generally to small businesspersons and small business companies.

First I would like to comment that the anticipated unemployment rate is indeed increasing and will increase within the next 15 to 30 days in our area. Generally, east Tennessee is a fairly stable and well diversified industrial area. But the companies I am aware of, I can pinpoint some 1,500 to 2,000 jobs that may be lost within the next 15 to 30 days.

There is one company on the news, I can announce it, Palm Beach announced last night on the news in Knoxville that they are contemplating closing a plant employing 600 people in the clothing industry. Another plant is on the ropes and will close probably this week, 130 persons.

Allied Chemical, which manufactures seat belts for the automobile industry, has announced that they are considering closing a plant in Knoxville, which would be 800 to 1,000 persons.

I cannot name him, but a small businessman who employs 25 people in the air-conditioning and heating industry has elected just to close. He is not broke, but he closed his business because of the interest rate and the inventory requirements. He cannot operate at a profit.

There are involuntary closings occurring. Of course, everybody knows the automobile-related industries like dealers and all are having problems in the area. But other capital-intensive industries are, too, whether or not it be highway construction. Of course, the building industry is down. Retail stores, people that require inventories have an automatic Catch-22 going. The inflation is requiring higher receivables. It is requiring higher inventories. That requires increased net worth, cash flow, or working capital. Then they cannot afford to pay 18- to 20-percent interest for the needed working capital. The end result is either involuntary closure by a creditor's bill or bankruptcy or a business decision to close before you go bankrupt.

This is not a rare occurrence in my observation of those people that I work with. The financial institutions apparently are unable to cure it also. For instance, small banks—I am not talking about Chase Manhattan—in rural counties that have lending capability of $200,000 or $300,000 are the typically small business banks. They are unable to maintain adequate working capital funds under the present reserve requirements to meet the needs of the people in their counties for working capital.

I do not have statistics. I was called too late to get any together. I will furnish some to Mr. Stewart so that he can get them to you. I know bankruptcies are up. I know that general creditors' bills are up. I will have those numbers to him before his next appearance.

I am only prepared to make a general observation that the result apparently desired is here. The small businessman is being emasculated by the present inflation and interest rate situation.

Thirty days is not soon enough, really, to start a corrective action for it. In 90 days or 6 months from now, there will be a lot of unrevivable small businesses in my area.

Thank you very much.

Mr. STEWART. Mr. Chairman, our next small businessperson is Ron Piercy of Kansas City.

Mr. PIERCY. Mr. Chairman, I am Ron Piercy. I am president of A-D-E Lumber & Supply Co., which is a wholesale distribution yard that sells building materials to retail lumber dealers. I am in between the manufacturer and the retailer.

Up until December I was employing 23 people, and I presently have 17. I have cut down that many, and it looks like I am going to have to cut down to about 12. I have been in business for 21 years this coming July. Up until this point I have never laid a man off. I have tried to be as prudent as I could. We take them through thick and thin, but this was an absolute necessity. So, that will give you an idea.

Our business is down 60 percent this year. We have a loss of $36,000 in the first quarter. I filed for a $17,000 rebate on taxes that we estimated to pay this year.

We sell small yards within a 100-mile radius of Kansas City. These people are in the squeeze. We are kind of put in the position of a banker because a lot of these people cannot get the funds from banks. So, we are, in turn, having to finance them to buy the materials, the small dealers in the small rural towns. We are having to pay 21.5 percent money, and we are able to charge 12 percent in the State of Missouri.

I do not know how much longer that can go on. You can appreciate that it will not go on too much longer.

As an industry, the plywood industry in general in the United States is one-third closed as of right now. I am talking about the Southeast clear through the West. They are shut down completely and people are laid off. There are towns like Libby, Mont., which is a small town in the middle of Montana, that has one large employer, St. Regis Paper Co. It has 640 employees that are out of work because it is shut up. There are 190 loggers connected with that company that have been out of work since the first of March. There are 200 independent loggers that are connected with supplying that mill that have been out of work since the first of March. In total, out of that economy you have 1,000 people. That is the type of havoc that we are going to see.

Big business is in a position to borrow their money cheaper than small business. They can sell bonds. They can get fixed rates. They can issue stocks and buy material cheaper. They pay an effective rate that is less than a small business.

Historically, what we are seeing happen in the building material business—this morning I was here listening to homebuilders, and they did not get involved in this, about homebuilding being one of the fastest inflating costs for the American people. The reason for that is because traditionally in these cyclical periods we see manufacturers in the lumber business go down and go out, and they do not start back up.

We see independent wholesalers like myself go out of business, and they do not start back up. We see small retail people go out of business, and they do not start back up. The voids are filled by big business in all of these cases. I think that this is one of the situations that adds to the home building costs because, when things level back out—we have got the real true demand that they were illustrating this morning. They did not shoot a figure to you, but I will. There are 43 million people that are going to turn 30 to 40 between 1980 and 1990. That is the primary home-buying market.

In 1970 to 1980, there were about 30 million that turned. So, you can see the increase in demand is going to be there. What happens is that there is less production and more demand. In the free enterprise system, that means inflation.

I had a real hurry-up meeting last week. I talked for just more than myself. I asked the SBA to put out a letter to association people in the greater Kansas City area, the four-State area. I was involved in the White House Conference and I am the chairman of that region, that four-State region area.

So, I called this meeting and asked the association presidents or executive people to come in for a very brief hearing. It was about a 2-hour-long thing of which I am going to give each one of you a copy that I have here of the minutes of that hearing. I am not going to get into that. I will skip homebuilding completely, but they have some repercussions there that are tremendous in terms of homebuilding. Homebuilding in the Greater Kansas City area is off 80 percent from what it was.

One figure that I remember briefly was 740 starts in March of last year in the Greater Kansas City area and 130 starts this year in March. So that gives you an idea of what has happened to that industry.

We have got people in here like farms. I come from a rural background. The Missouri Farm Bureau and the Iowa Farm Bureau, I have met with them and talked with them. They have called in their agents to give me information. I am going to tell you that it is devastating. There again, you go back to the same premise about what causes inflation. If you will just imagine the Iowa farmers and the Missouri farmers as a unit, those two, I am sure of this, are going to cut their fertilizer requirements by 30 to 50 percent. They are not going to fertilize the crops as much. They are going to cut their tillage because of the cost of diesel fuel and gasoline by how much, who knows, because they cannot borrow money.

Mr. LaFalce. So, food prices are going to go up, and that is going to exacerbate inflation.

Mr. Piercy. What is going to happen to food in the fall, gentlemen, when this kind of an impact starts coming through? And this is the time to plant those crops.

What I am saying, when they are talking about 30 to 60 days, we do not have any time. We need emergency measures in certain areas of the economy. I think the homebuilders were illustrating it. I think they are an area.

Small business in general is suffering. We are right on the verge, in my judgment, of a complete collapse of a large, large percentage of the small business community. We have met with the Federal Reserve——

Mr. LaFalce. That is one of the problems I have with the administration's anti-inflationary policy. The voluntary policy is going to have primarily a macroeconomic effect. Insofar as balancing of the budget is concerned, the overwhelming effect of that is psychological in nature. You know, everybody is in favor of a balanced budget. I favor a balanced budget, too. But let us not kid ourselves. The impact of that economically, in pure economic terms, is going to be 0.1, 0.2, 0.3 of 1 percent. To the extent that it will dampen the inflationary psychology that exists, it might be considerably helpful. But I have my qualms about that.

We need targeted policies to cope with food supplies, targeted policies to deal with the effects on small business, targeted policies on energy. The price mechanism, which is the primary means that has been used, in my judgment, to cope with the need to develop greater conservation, is inflationary in and of itself.

Your might disagree because business usually says: Oh, we have to deregulate and therefore use the price mechanism on energy. Well, the price mechanism guarantees inflation. We have seen it. The reduction in energy usage is in no way commensurate with either the price increase or the inflationary increase.

Mr. Piercy. Well, I propose you will not have a budget. That is what I am saying. You are not going to have one to balance within 60 to 90 days because you are going to have such an unemployment figure that taxes and revenues are going to be off so much that it is going to compound the problem that we have, which is capital. The Government is going to go back in and start trying to borrow money.

We have dialoged with the Federal Reserve in Kansas City and here. We are sympathetic that they have appeared up to this point to be the only inflation fighter in town; they think that. But we have not been able to get across to them that all credit needs are not the same. Small business is locked into a monetarist policy. Small business—and I mentioned a while ago that big business can borrow cheaper, can float bonds, can issue stock, and can do all this various number of things. Small business has a source of capital: We can either borrow from the bank or from our mother and dad, and what kind of retained earnings that we are able to retain into our business. That's it.

When we are locked into that position and the interest rates go from 12 to 21.5 percent, brother, we are out of business. It is just as simple as that.

I will go ahead and give you those sheets. I will not talk about the automobile dealers in our area, but I will tell you——

Mr. LaFalce. Have you people also been talking to SBA about their tendency to eliminate direct loan money?

Mr. Piercy. We have been talking to them about several things. There are two other things I want to say, and then I will pass it on.

There was an interesting thing, I think, in the motel-hotel association president regarding two of the largest hotels in Kansas City. This really, if you think about it, is devastating. It shows who is hurt. He says that 80 percent of the employees in those hotels, that industry in our area, are minority groups. They are having cancellations, gentlemen, by such people as doctors' conventions. Now, there is not any more an affluent group that I know of in this country than medical people, doctors. And they are having cancellations in one instance of 500. It was pointed out that there were 500 reservations, and they had over 200 cancellations. This thing is widespread.

You can find areas of the economy that are not affected. You can find cities and you can find States that are not affected. But I——

Mr. LaFalce. Not too many.

Mr. Piercy. But I will guarantee you this. My part of the country is the center part of the United States; Missouri, Iowa, Kansas, and Nebraska. Without question, it is widespread in my part of the country. We have 659,000 small businesses. That is one of the largest strongholds of small business in this country anywhere as a percent. If we lose—and my figures have been 20 percent. We have been battling over this and trying to come up with programs and try to get everyone to realize what kind of a situation we are in.

Suppose that we only lose 20 percent of small business through shutup or—which is what farmers do. They usually do not take bankruptcy. They just close up the door and go on and maybe go with mom or dad or something. But bankruptcies and closeups, if we have 20 percent of the small business area in my four-State area, think what kind of a catastrophic implication that that really has when you are talking about 659,000 businesses with maybe an average of five employees, over 3 million people, 20 percent gone out. Look what has happened.

I do not know what else to say to you. We are trying to come up with programs. We have made recommendations. Essentially what we have got is a problem of the interest rate squeezing us to death. We need a relief of interest. We need it quick, the quicker the better.

We have been dialoging with Federal Reserve because we felt like they could have the faster impact on interest rates if we are going to come up with some solutions, which takes time, on the overall inflation problem. That is where we stand.

Mr. LaFalce. The White House Conference on Small Business came out with some excellent recommendations.

Mr. Piercy. Yes; they did, but that is long term.

Mr. LaFalce. Precisely. They are not designed to get you through the crisis.

Mr. Piercy. Absolutely.

I have here a letter that I wrote to the Federal Reserve members in the Kansas City district. I thought all those board members ought to know what I think and what these people are reporting. I wrote to all the directors. There is a letter that I have written about going out of business. Then there are these minutes of that meeting that I am talking about where we had 25 associations plus accountants and various people. Lastly, there are a couple of reports. One of them is statistically provided by the Real Estate Board of Kansas City. It is all written out. There is one from 2,900 contractor members of an air-conditioning and heating sheet metal group.

Mr. LaFalce. You talk about going to the Kansas members of the Reserve. Within a few days after October 6, when Chairman Volcker got out the special policy, he and I had breakfast together. I was urging upon him the necessity of communicating that the bankers of America, talking about the special consideration that should be given to small business and home building, et cetera. He sent a letter to the chief executive officers of all the banks in America urging that they adjust their loan rates for small business. Basically, I interpreted that as a two-tier policy perhaps. But the policy is that two-tier policy is going to bring you down from 20 to 21 percent to 18 or 19 percent, even if a bank is going to have it. And that is not going to be of any significant help.

Mr. Piercy. We have had a two-tier system in this country for a long time. We have got a prime rate tier for big business. And we have an above-the-prime-rate from anywhere——

Mr. LaFalce. He is talking about a two-tier the other way, but it probably does not really work that way. The definition of prime rate is almost reverse two-tier from the concept that we would espouse.

I am not sure that I know exactly what should be done in a short-term basis. If you people have some ideas——

Mr. Piercy. Lower the interest rates.

Mr. LaFalce. But how do you just lower the interest rates?

Mr. Piercy. How did they go up?

Mr. LaFalce. The Federal Reserve is going to testify tomorrow. They are going to say that the interest rates follow inflation. And the only way to get the interest rates lowered is to, you know, combat inflation. They will say that we want to do it as badly as you.

But we have to understand which comes first. And it is inflation which is causing the high interest rates.

I think, in large part, they are right. Certainly, high interest rates can have an exacerbating impact on inflation, to be sure. But, in large part, it is the high inflation that causes the high interest rates, which then reinforces it. I think interest rates more reinforce inflation, you know, than cause it.

So, what program do we come up with? Is it floating bonds——

Mr. Piercy. There is an artificial amount of interest rates between what is being charged now and what they really ought to be, in my judgment.

Mr. Stewart. Mr. Chairman, if I may, we will try to come in—there have been some specific suggestions offered to us from within this group and other small business people. We will try to bring some of them that stand the scrutiny of exchange and dialog when we come back.

Mr. LaFalce. When you come in—which is going to be the 13th—what is going on that week?

Mr. Stewart. That is National Small Business Week.

Mr. LaFalce. When you come before my committee on the 13th, as I have requested, with a strategy to help small business combat inflation, will you be speaking for yourself, for SBA, or for the administration, hopefully?

Mr. Stewart. I cannot presume to speak—I am anticipating, Mr. Chairman, I think I cannot speak for the administration on some of the matters I expect to cover.

I think I will be speaking for SBA on matters involving SBA. I think on some of the issues that I think have to be addressed, I am going to be talking only for myself and maybe for 1 million small business people.

Mr. LaFalce. I just might invite OMB to testify on the 13th also.

Mr. Stewart. I am not sure it is a violation of the sedition laws for me to say that is a good idea.

But I think there are better spokesmen for the administration than I can possibly be at this time, Mr. Chairman. Let me summarize before we have our next witness.

Mr. LaFalce. You are an advocate for small business, not for the administration.

Mr. Stewart. That is correct. I am in the Government but not of it from many standpoints, and that must be the case.

Mr. LaFalce. Right.

Mr. Stewart. Our next small business person is Sam Pasch of Milwaukee, Wis., who, in addition to running his own business, is this year's president of the Men's Wear Retailers, a 10,000-member trade association.

Mr. Pasch. Mr. Chairman, I am Sam Pasch, president of Polacheck's of Milwaukee, which is a men's wear specialty store. We have been in business for 93 years. I am also president of the Men's Wear Retailers of America, as was pointed out, which is an organization of 10,000 smaller men's wear specialty stores.

We are greatly affected by the inflationary methods that have been taking place, specifically as far as the high interest rates are concerned. We realize that our business is seasonal. It therefore becomes imperative for us to be able to go into our banks and obtain the necessary capital in order to be able to buy the necessary merchandise and still be able to maintain at least our volume a [illegible] as our businesses are concerned.

Particularly today with the consumer credit and the like, it requires also having to assume more of our accounts receivable which in turn will necessitate having to go to the bank. We find in going to the banks that the banker, even though I have been doing business with him for the last 30 years or more, he is not as receptive.

Furthermore, with the high interest rates such as they are, we cannot possibly reflect this as far as our margin of profit is concerned, our gross markup. As a result, with the increased operating costs and with the increased interest rates such as they are, it is important at this time that we at least get immediate relief. It is not a case of waiting 120 days or 90 days or 6 months from now or whatever the case may be. It is important that we take necessary measures immediately as far as lowering interest rates and trying to at least give the small businessman the kind of consideration that he deserves today in order to survive.

Thank you.

Mr. LaFalce. Thank you.

Mr. Stewart. Mr. Chairman, you have now heard from a manufacturer, a wholesaler, and a retailer as well as an attorney representing all three and small banks. Our next witness is Santos Abrilz of New York State. I will let him tell you who he is.

Mr. Abrilz. My name is Santos T. Abrilz, Jr. I am president of Apoca Industries, Inc. We are a small telecommunications equipment manufacturer located in Deer Park, Long Island, N.Y.

Mr. LaFalce. I believe I read in Future magazine that they surveyed about 80 different securities analysts. They wanted them to pick the industry of the future for the 1980's and rank them up to 10, 10 being the highest. All of them were from one to eight except for one industry. One industry broke through and got a 10 rating. That was the telecommunications industry.

According to the 80 securities analysts, you are in the industry of the eighties insofar as growth is concerned.

Mr. Abrilz. That is right. My competitors are no problem. Inflation, high interest rate, and Ma Bell—so.

[Laughter.]

Mr. Abrilz. I also served on the followup to the White House Conference on Small Business.

The inflation our country is facing today obviously has brought us to a point of economic crisis that our Nation has not seen since 1930. The present crisis means that at a minimum many new promising companies will be unable to expand. My company is one of them.

Even though our business is growing—and it is growing and we have a healthy backlog—we have been forced this year to stem our growth by delaying our plant expansion. Plant expansion meant the creation of 120 new jobs. We are now going to be forced to half that by renting new space and only adding 60 jobs. But, if we do not get enough capital within the next 90 days to carry our cash flow forecast for the next 18 months, it is conceivable that one of your new promising telecommunications industries will be dead by late October or early November.

The Federal Reserve Board anti-inflation monetary policy has had the following impact on small business. As a result of the Fed's action in raising interest rates, banks passed the higher rates to small busi-

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ness, money has become tighter, and high interest charges have kept small business out of the loan market.

S. & L.'s borrow short-term money from depositors to fund long-term mortgages on homes and also to give out loans. A major risk in borrowing short and lending long is that inflation in a credit crisis will drive short-term interest rates to a level above the average returns received on long-term mortgages. That risk is reality today. Most of America's S. & L.'s are losing money or soon will be.

The losses get worse with each passing month as certificates of deposit issued when interest rates were lower roll over at today's high rates. Without realizing it, bankers are acting to cause the very wave of loan losses they fear. They currently charge their prime borrowers 20 percent. They charge small business 22 or 23 percent. This is far above the 10 to 12 percent rate that the typical industrial company earns on its assets.

It does not matter how efficient we are. We can be 15 or 16 percent efficient. We are still not able to be that efficient to carry the interest rates that are current today. Most corporate borrowers will go bankrupt in time if they continue to borrow at today's interest rate. But they are so dependent on debt for working capital that they have no choice. I am talking about small businesses.

Banks prefer to loan money to borrowers in such good financial condition that they really do not need the money. Banks have enacted stricter lending policies, and it has become difficult to qualify for a loan.

An interest to be addressed is the Federal Reserve regulation that loans should grow no faster than 6 to 9 percent this year, with small businesses being exempted. At no time was this meant to clamp small business loan demand to the 6- to 9-percent figure. Yet, this is what is occurring in the New York area.

Struggling small businesses are hardest hit. Loan money to keep marginal operations afloat will not be available on the open market.

I should substitute marginal operations by good concerns. Our problem today is that we are affecting the companies. We know we are going to lose marginal small business. We know we are going to lose mismanaged small businesses. We are not worried about those. We are worried about the hard core of small business who have qualified products, have good payrolls, good employees, are good productivity type of operation, but cannot get the funds in order to maintain cash flow.

For example, a typical—let's go over an 18-month period where you have a $6 million program, which you have $4 million worth of material, $500,000 worth of labor, $500,000 worth of G. & A. and about $350,000 worth of other expenses in there. The problem is in meeting the material flow. If you do not get the material, you cannot make the product and thereafter get the cash back in.

Most of the time all you need in a $6 million operation is $200,000 to $300,000 of other cash in order to finance that operation for that 18-month period. The rest of it will be financed by the shipments that you bring out. The problem is that we cannot get the $300,000 unless we get it at 24 or 25 or 23 percent if it is available and only if you have been successful long enough so that the banks will believe you will be around in order to repay their note.

So, the loan qualifications requirements are imposing on consumer loans and home mortgages. Loans for new construction are tight. Despite reassurances to the contrary, the housing industry is hard hit, 90 percent on Long Island. We cannot sell a home in Long Island. You cannot sell a home because everybody is trying to sell them. That is a very, very serious crisis on Long Island. The housing industry on Long Island is nonexistent for all practical purposes.

Mr. LaFalce. I invite you to come to my congressional district to the village of Albion in Orleans County. It has a population of 5,000. The Lipton plant employs 500 people in a village population of 5,000 closed down.

Mr. Abrilz. See, you are talking about a large business. If you have five of us and five of us go under, you have the same impact.

Mr. LaFalce. The impact that it is having on the small businesses in my community is devastating.

By the way, Mr. Stewart, could you give me a fast reading of whether section 7(b)(9) might be applicable in a situation like that?

Mr. Stewart. In Albion?

Mr. LaFalce. Yes. I do not mean now.

Mr. Stewart. Yes.

Mr. Abrilz. There has been strong business inventory in recent weeks especially for small businesses. There is increased unemployment as small businesses attempt to cut costs wherever possible. Obviously, the key way we cut costs is by laying off people hoping that we can return them and keep laying off until finally we do not have enough people to produce the product that we are supposed to be producing.

Smaller banks are squeezed worse than larger banks since high interest rates on short-term instruments such as treasury bills drain off savings deposits. These problems are rippling back to exaggerate small business credit problems in general.

In summary, small businesses with limited resources, limited credit alternatives, limited access to investment capital, and with limited flexibility save extinction for a good 40 to 45 percent of the hard core small business sector of our economy.

We are saying that the reason we are here as small businesses and small businessmen is that we do not have the time to wait for White House Conference implementation. We do not have the time to wait for the Federal Reserve Board to find out that we are in trouble. We do not have the time. We are here to warn you as businessmen that the real world out there outside of Washington is in serious, serious trouble. You are talking about Kansas, New York, Missouri; the whole world in terms of small business is in trouble.

We are here with facts, and we are going to get the facts. But in the meantime we want you to sort of realize that this type of hearing, although essential, is not what we want. We want to implement a good policy that can work together with Government and small industry working together to save a vital part of our economy.

Mr. LaFalce. That is the reason I am holding the hearing. That is the reason I am asking for suggestions. I am not sure exactly what short-term interim steps can be taken to bridge this gap to avoid the economic dislocations. That is why I am calling this.

Mr. Abrilz. We have ideas and——

Mr. LaFalce. We have got to get our ideas together. We have to pool them together as fast as we can to try to develop something.

I agree with you. We cannot wait for the implementation of the White House Conference with the recommendations, however many there were. The administration had better realize it or they will not be the next administration. And Congress better realize it. Whether the other Congressmen realize it or not, we are going to have a higher loss rate for incumbents in Congress than we have had in a long time. Generally there has been dissatisfaction against the institution of Congress which has not transferred itself to the individual Congressmen. We now see, in my judgment, a transfer of the hostility toward the institution to the individual. If others do not realize it, they will at the end of November.

Mr. Stewart. Mr. Chairman, our windup heavy hitter is Bob Carr of Philadelphia. I will let him tell you about himself.

Mr. Carr. My name is Bob Carr. I am the founder and chief operator of Systems Engineering Associates Corp., which is a naval architect and marine engineering firm. It has eight offices up and down both coasts with corporate offices in Cherry Hill, N.J.

We employ 350 people. We are a growth small business company, and someday we hope to get out of small business.

I have another hat. I am the temporary chairman of the White House Conference on Small Business Implementation Committee.

You are correct when you said that we do not have time to look at the 60 options and 11 resolutions that were developed during that yearlong process. We heard testimony during March 16 and 17, when we held our implementation meeting here in Washington to decide about an ongoing organization, how to get things done.

That is where the issue of small business survival became apparent to all of us. I think, sir, what you see here today, if you have a good sense of history, you see the small business minutemen because we are unorganized, much like the minutemen back in the great Revolution. On the way to Boston, they marched and organized themselves. They did not win, but they communicated.

The point that we are trying to make is the one that you are trying to assist us with. It is survival. Of the 14 million small businesses in the country, 40 percent of us are retail; 40 percent of us are service. We are labor intensive. We must make payroll. Where does the money come from? We have no capital. We have one source. Usually it is the bank.

Many of us deal with small bankers. They do not have it to lend. What happens?

We do not have a recession cushion which the inflation policy that we are currently working on assumes; we are either in business or out of business. That is general. Now I will give you a specific from my company.

Roughly, 65 percent of SEACOR's annual revenues come from the Government sector; 35 percent from commercial firms. The relationship is not borne out in a look at our accounts receivable; 83 percent of our receivables are 15 days or older are from the Government; 91 percent of the receivables over 30 days old are Government; 100 percent of the receivables over 60 days old are Government.

We have $495,000 in receivables over 30 days old; $450,000 of this is somewhere in the Federal Government being processed. We have $124,000 that are 60 days old. The oldest invoice is 164 days.

What we are saying here is that we are borrowing money at 21.5 percent interest to make payroll, but also to pay for the Federal Government's inability to make payment to their suppliers on time. Not only that, but in the overhead factor in the Government contractors—the contracting business—you do not even get credit for the cost of money.

The result is, if I continue with this, $294,000 a year interest and the cost of supporting the option of working for the Government.

We have some recommendations to streamline the small business payment procedures, to provide payment for goods and services within 30 days which are in the terms and contracts of all Federal contractors. It is not being done, sir. It needs to be done. This would improve the small business cash flow.

I will leave a copy of this for the record.

I also am coming from somewhere else. My family has been 12 generations in this country representing 7 individual small businesses. I owe it to them and to this great country to come here and try and do my business with a company that is responsible for a good part of the small business, the naval architect business. I do not know where we can find all the time to support this minuteman brigade that you see here, but we will find a way.

We are in serious trouble. We need everybody's help. Thank you, sir, for your time.

Mr. LaFalce. Thank you, sir, very, very much.

I have a couple of things. First of all, can you stay after the meeting and give me the positions that each of these gentlemen had with respect to the White House Small Business Conference?

I think it is an apt description that you have given: The minuteman brigade on behalf of the small business community.

There was the suggestion that we come up with a national strategy for small business to cope with inflation. You are going to present that in testimony——

Mr. Stewart. Yes, sir.

Mr. LaFalce [continuing]. On Small Business Week, the 13th. I look forward to that, and to work with you on that.

I want to make another suggestion. As a matter of fact, I am telling you now that I am going to introduce a resolution and write to the President, and I urge you to get behind it, too, to change the name of Small Business Week for the year 1980 to Small Business Survival Week. Let us get across the idea right now that we have an unbelievable crisis on our hands and that we can no longer afford just to talk about the implementation of proposals that will affect small business in the future, meaning a year from now or 5 years from now. But in the year 1980, come the second week of May, all the attention of America should be devoted to the survival of small business.

Tomorrow we are having a big business day according to Ralph Nader. Tomorrow we are having an economic growth day according to big business. Well, let us be unified. Let us have the week of May 13, Small Business Survival Week.

Mr. STEWART. Mr. Chairman, let me say by way of response only one thing. I think we should end on a hopeful note because you cannot be in small business unless you are hopeful.

One of the things I think came out of our discussions yesterday and today is the fact that cash flow is more important to small business survival than profitability for the next year. These men have all agreed to that. We will come back with a small business lifeline cash flow program of some sort. I cannot tell you what it will be. But I do know from one of our other small business people that we will, all of us, try to get the banks of this country to do what some banks are doing.

We know of at least one which has broken the interest rate down for its small business customers, its good credits. And it has said: If you are paying 21 or 22 percent, if you will pay 15 percent of it on a current basis, we will escrow the obligation for the other 6 percent until you can catch up. They are obviously adding it to principal.

Mr. LAFALCE. Terrific.

Mr. STEWART. OK? Now, as far as I am concerned, we can fan the air here by the hour. But, if we can get enough small businessmen to talk to their banks and get them to do this, that is probably the best single short-term thing we can do.

Mr. LAFALCE. As long as we have got the 1969 Credit Control Act on the books—you know, query whether it should have been implemented; query whether it should exist—but, if we are implementing it, I wonder—and, believe me, I will be asking the Federal Reserve when they testify tomorrow before me for consideration of using the 1969 Credit Control Act to have the banks do exactly that.

Before you leave today, could somebody from your staff break that down for me in greater detail what banks are doing and how they are doing it so that I can be really ready and loaded tomorrow?

Mr. STEWART. We can only give you one specific example. We will give you two or three paragraphs as it has been explained to us.

Mr. PIERCY. I would like to have 1 more minute. I wanted to leave you with a couple of things.

I have had a couple of ideas about what to do. The first one is not liked too well. But what I was asking for was a moratorium period, say, of 6 months. Roll interest rates back for small business to a maximum of 15 percent. To pay for this, the only concept I could come up with was for the Federal Reserve Board to lower the requirements for banks who participated in this commensurate with the amount of money that they would lose between the going interest rate of 21 percent and 15 percent.

Mr. LAFALCE. It is not that unusual a request. Whenever we give an SBA guarantee, for example, the amount of the SBA guarantee, I believe, can be used as an offset against reserve requirements. Am I correct in that?

Mr. STEWART. I am not sure, but I believe you are right.

Mr. PIERCY. The problem I have with it now, after I have studied it a while, I have had this thought for 3 or 4 weeks, is that, if the Federal Reserve Boards have as much a problem with banks to get them to realize that this 6 to 9 percent growth factor that small business and farmers are excluded from. But then I think we might have a real problem with this, too.

The other thing that I have to offer is this. What do you think about a bill or resolution, whatever—I do not know the legality of these things. But it would be something that would come from Congress that would exclude the bank's income from interest to small business for a period of 6 months, which would immediately lower the interest rate to small business to probably 10 percent, which is more in line with what big business is paying, in order to give them this period of time to adjust and for some of these other measures that are in the works to take the time to begin to have an effect?

Mr. **Stewart**. You mean exclude from the basis of taxes?

Mr. **Piercy**. Yes; just the basis of taxes, just for that period of time to banks, that loan to small business only. You are talking about an impacted amount of money. It is something that might take some time to do. But, if you could do it quick enough, bankers tell me that it would work.

Mr. **LaFalce**. You might have a lot of problems with that.

Mr. **Piercy**. You would, but those are two things to think about.

Mr. **LaFalce**. Yes.

Mr. **Stewart**. Thank you very much, Mr. Chairman. We appreciate your listening to us.

Mr. **LaFalce**. Thank you very much. I think it has been a very fruitful discussion. We will see you on the 13th, sir.

I would now like to call both HUD and CWPS to the witness table.

We will now hear from Elizabeth Roistacher, Deputy Assistant Secretary for Economic Affairs of the Housing and Urban Development Department.

Ms. Roistacher, I am going to introduce into the body of the record the entire text of your remarks, and I would ask you to summarize, please, to summarize your remarks, as you so desire.

TESTIMONY OF ELIZABETH ROISTACHER, DEPUTY ASSISTANT SECRETARY FOR ECONOMIC AFFAIRS, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT; ACCOMPANIED BY KEVIN VILLANI, ASSISTANT TO THE DEPUTY ASSISTANT SECRETARY

Ms. **Roistacher**. Very well. I will try to stay under 10 minutes.

Mr. **LaFalce**. Thank you. Without objection, your statement will be included in the record at this point.

[Ms. Roistacher's prepared statement follows:]

Prepared Statement of Elizabeth Roistacher, Deputy Assistant Secretary for Economic Affairs, Department of Housing and Urban Development

I am happy to be here today representing the Department of Housing and Urban Development. Thank you for giving me the opportunity to discuss the impact of inflation on small business.

You have also asked me to address concerns regarding the Administration's anti-inflationary policy. Accelerating inflation eventually requires an anti-inflation policy which runs the risk of a recession. Some of the worst effects of inflation on small business are not felt until after the economy begins to cool. Thus my comments will address the distributional effects of both inflation and recession.

The Department has four levels of concern for small business. First, the Department is acutely concerned with the general health of minority and disadvantaged enterprises and is taking specific steps to address these concerns. Second, the Department is concerned with the health and viability of the many small firms in the housing sector of the economy which are a key element in the delivery of programs and in achievement of the Administration's long-run housing goals. Third, the Department is concerned with the viability of small business in urban areas which is a principal component of the strategy to achieve our urban goals. Finally, the Department is concerned generally about the viability of small business in recognition of their important role in the economy. My testimony will address concerns over the combined inflation-recession impacts on small business on their four levels.

Before turning to the particular concerns of HUD, let me begin by making some general points about the importance of small business to the economy and the impact of inflation and recession on these businesses.

Small businesses are important to the economy because of their role in promoting increased productivity. Studies have shown that it is not the largest firms but those in the small and middle range which have contributed the most to innovation and technological change. Small businesses also have important employment effects; one report prepared for the Committee on Small Business noted that between 1969 and 1976 virtually all new jobs in the economy were created by small business.

But small businesses are particularly fragile enterprises. Small businesses are not only especially vulnerable to an accelerating inflation, but also to restrictive credit and business downturns. The turn to more restrictive credit policies, although necessary to reduce inflation, may affect small firms disproportionately since they are the first to be squeezed out. My subsequent discussion will expand on these points. In addition, secular patterns of industrial development have been working against small businesses—especially with respect to financing arrangements which are a key not only to maintenance of on-going production and sales processes but also to fostering research and development activities, which stimulate productivity.

HUD'S EFFORTS TO ENCOURAGE SMALL MINORITY AND DISADVANTAGED ENTERPRISES

Your interest in small business and inflation coincides with the commitment of the Department of Housing and Urban Development to assure that our activities work directly to encourage small minority and disadvantaged business. I should emphasize that our commitment to these businesses extends beyond the problems they face as a result of short-run economic fluctuations.

Our agency is mandated by PL 95–507 to aggressively pursue and implement stategies designed to triple the level of our Small and Disadvantaged Business Procurement based on goals jointly agreed upon with the Small Business Administration and the Office of Federal Procurement Policy. These goals, which were just recently agreed upon on March 31, 1980 are set forth in Attachments A & B.

In order to achieve these goals our agency has recently designated a Director for our Office of Small and Disadvantaged Business Utilization. This office is currently in the process of defining its role in the agency, developing a work program and putting together a staff. This office will be fully operational in the near future. This development is occurring at the same time as our agency continues its efforts to institutionalize assistance to small businesses. Each program area within the Department has prepared a specific plan for assisting minority and disadvantaged businesses. These plans are still under review and need reworking, but some of these plans truly represent innovative and real opportunities for assistance to small and disadvantaged businesses. For example, in our Housing office we are reviewing plans which would encourage the economic development of small businesses through the use of local housing authority procurement. In addition, we are considering setting aside a certain portion of modernization funds for small and disadvantaged businesses, perhaps as much as 20 percent.

Although it is not yet fully operational, the Secretary has already given the new Office of Small and Disadvantaged Business Utilization several assignments. For example, he has directed them to review the whole question of bonding requirements and to explore how to assist small and disadvantaged businesses to be able to compete more effectively in the marketplace. Also he has asked this Office to consider the use of Minority Enterprise Small Business Investment Corporations, joint ventures and other innovative arrangements in order to increase both the dollar amount and the institutional impact of funds administered by this agency on small businesses.

The Department has also initiated several studies of assistance to small and disadvantaged business which will help us design strategies and actions to funnel added contract dollars to these firms.

In addition to the actions we can take through our own procurement and program activities, our concern for small businesses extends to activities beyond our immediate control.

EFFECTS ON HOUSING AND HOUSING FINANCE INDUSTRIES

It is well known that the Department is greatly concerned with the ability of this country to provide housing to our citizens. The housing sector is dependent on residential construction and rehabilitation activity, industries that are dominated by small businesses.

Housing construction involves many different kinds of businesses, and the great majority of these are small, even though there are firms of all size classes involved. The average home builder employs 13 construction workers, and construction subcontractors average fewer than ten employees. The housing industry also includes small firms engaged in housing repair and rehabilitation. Suppliers of materials to all these firms are also generally small businesses. Moreover, the housing finance system has come to depend increasingly on the mortgage banking industry, especially for FHA financing. About 85 percent of FHA loan originations are made by mortgage banking firms, which are predominantly small businesses. Hence, HUD's concern for the housing sector naturally translates into concern for small business.

I would like to distinguish between the long term effects of inflation and the short term effects, which include the costs incurred as we attempt to bring inflation under control. Over a long period with steadily rising prices, both firms and households adjust to inflation by investing in assets that increase in value as price increase. For consumers homeownership has proved to be the most dependable way to do this. Homebuyers can adjust to long periods of steadily rising prices and businesses can do likewise. Inflation premiums become "built into" interest rates and higher prices can be charged to offset higher costs.

A low, steady rate of inflation in which there is little uncertainty has always been acknowledged as a healthy economic environment, promoting investment, economic growth, and a higher standard of living.

However, rapidly accelerating inflation and the associated uncertainties that accompany this take a heavy toll on both households and firms. For households, the economic and psychological uncertainties feed upon one another.

However, rapidly accelerating inflation and the associated uncertainties which bear the greatest economic burden in such an environment.

Accelerating and uncertain rates of inflation greatly increase the risks inherent in doing business. For example, rapid increases in interest rates have a direct impact on small business through increased costs. This often hits small businesses harder than big businesses since small firms cannot rely on internal sources of funds to meet short term financing and inventory obligations as the large firms can, but must turn to lending institutions for their short term capital needs. Maintaining inventories costs more in such an environment, and fluctuations in both prices and sales can leave a business over-extended. Due to their greater financial resources, large diversified firms can ride out such storms better than small firms. The sharp decline in housing sales, for instance, has left many builders with a huge unsold inventory of new homes which is being financed at construction loan rates exceeding 20 percent. At the end of February, homebuilders held an unsold inventory of 384,000 new homes, or more than a nine month supply at the February sales rate. (A six month supply of inventories is generally viewed as normal for the industry.) About 30 percent of these inventories are complete, and another 55 percent were under construction. Although the unsold inventory has been declining, sales have declined also, so it will take builders some time to work down their inventory to acceptable levels.

The Department of Housing and Urban Development is concerned not only with inflation, but also with the companion issues of the effects of anti-inflationary policy itself and of the related prospect of a business downturn which has already started to appear.

High interest rates are one glaring result of inflation. As you are aware, efforts to fight inflation by tightening the availability of credit lead to even higher interest rates in the short run, as we have been experiencing in recent months. However, in the long-run, such a policy will result in a lower rate of inflation and a more stable economic environment which will be good for business, especially small business. High interests rates, however, do have a disproportionate effect on housing construction, due to the effects on the supply of mortgage credit available at thrift institutions and due to their impact on the cost of borrowing.

Changes in financial institutions have made the housing industry less vulnerable to one impact of inflation which had traditionally played havoc with it, that is, the problem of disintermediation—the withdrawal of funds from mortgage lending institutions as their interest rates lagged behind short term investment opportunities elsewhere in the economy. The introduction of GNMA pass-throughs and of money market certificates has reduced somewhat the vulnerability of the mortgage industry and thus of the home-building industry to the problem of unavailable credit. The preemption of state usury ceilings permanently instituted with the signing of the Depository Institutions Deregulation and Monetary Control Act of 1980, just last month, along with the phasing out of interest rate ceilings for thrift institutions, further buffers the housing sector from credit shortages.

However, housing demand has always been more sensitive than the rest of the economy to high interest rates. The problem faced by the housing sector today is less the availability of funds when interest rates are high but more the high cost of homeownership and its translation into a lower demand for housing. While a long period with a constant low rate of inflation may not adversely affect the demand for housing, a short term jump in interest rates as a result of an aggravated inflation can be devastating to housing demand. A doubling of interest rates causes monthly mortgage payments almost to double. Therefore, in spite of the prospect of rising home prices, demand will fall off.

The current climate of high interest rates has clearly had a strong impact on housing. Housing starts declined from a level of over two million in 1978 to an annual rate of 1.33 million as of February 1980. (The figures for March are being released by the Department of Commerce this very afternoon.) I have already noted the high inventory/sales position of Homebuilders.

As inflation accelerates, it feeds upon itself, as price increases tend to be built into all types of contracts, including wage settlements and financial instruments. Strong medicine is necessary because of the self-aggravating nature of the illness. The steps which inevitably must be taken to reduce this inflation could lead to a recession. If a recession occurs, failures of small businesses will accelerate as the initial problem of over extension of inventories is perpetuated by declining demand for and prices of their products. Business failures are concentrated in small and moderate sized firms. Less than 5 percent of failed businesses in 1978 had liabilities in excess of $1 million. The problem of failure is clearly aggravated by the business cycle. For example, between 1973 and 1975—our last serious downturn—failures in the construction industry almost doubled, rising from 543 to 942. Since these data refer to business closings where creditors lost money, they greatly understate the number of firms going out of business.

The impact of inflation on housing demand translates into serious economic consequences not just for homebuilders but also for the rehabilitation industry and for suppliers to builders and rehabilitators of housing—all small businesses. The impact on rehabilitation is important to the Department not just because of its housing market implications but also because of the importance of such activities to the revitalization of central cities. So let me now turn to the subject of urban decline, small business, and inflation.

EFFECTS ON URBAN AREAS

The Department of Housing and Urban Development has a special mandate to promote urban economic development. Our Community Development Block Grants and Urban Development Action Grants are perhaps our best-known tools for these activities. In conjunction with this Administration's effort to improve the economic and fiscal well-being of America's declining cities and suburbs, HUD has become even more determined in its efforts to promote urban economic development and the fiscal health of cities as a means to improving the well-being of the people living there. Related to our concern for the health of urban economies is our goal of increasing opportunities for minority employment and minority business. We have made progress in the areas of minority employment, minority enterprise, and other areas of social concern: this progress has been due in great measure to small businesses located in our cities. Inflation and recession threaten this progress.

Historically, small businesses of all varieties have been crucial to the overall economic health of the cities. Traditionally, they have provided a unique opportunity to the lower income and lower skilled population for upward mobility through occupational training and equity building. In addition, cities with a large share of small business have often been characterized as "incubators" of new ideas and new technology. Hence, the nurturing of these businesses is important for their link to opportunities for upward mobility as well as for productivity—and, therefore, for providing central components of the economic vitality of cities.

The general impact of inflation on small businesses that we discussed earlier applies to the problems of small businesses in central cities. The problems of central cities are compounded when inflation and recession are linked together in aggravated business cycles, as seems to be inevitable in our current economy. For example, research by Bennett Harrison and Edward Hill of MIT (1977) has shown that small firms employing low-wage, part-year workers are very sensitive to the business cycle, especially in Northeastern cities. The layoffs faced by the low skilled create a dramatic reduction of alternatives to one group of the population, forcing them to bear a disproportionate burden of the recession.

In addition, a business downturn has the effect of accelerating the death rate of the small businesses that are often found in older cities and central cities. Since the births of firms that come with the recovery are less likely to be in older areas and in central cities, the cumulative effect of a business cycle is to exacerbate the erosion of the economic bases of both older cities and central cities. While new businesses will be formed after the recession ends, they are unlikely to reappear in the same areas.

Research by Kathryn Nelson and Clifford Patrick (1975) has found that over the course of the business cycle, a decentralization of industry occurs. Business deaths in central cities accelerate during the downturn, and business births outside central cities accelerate during the upswing. This decentralization has been found to be a pervasive nation-wide pattern rather than a "pathology" associated only with declining areas.

Business failures in older cities of the North and East would exacerbate their fiscal and economic problems. Recovery from recession may be less than complete in older and central cities as businesses fail to reappear. Studies by Peter Allaman and David Birch of MIT (1975) have shown employment shifts among regions are not generally due to movements of firms, but rather to births and deaths of firms, and expansions and contractions of existing firms. A study by Carol Jusenius and Larry Ledebur (1977) found that while death rates of firms did not differ significantly between the North and the South, births of new firms led to an expansion of employment in the South that was three times the rate of expansion in the North. This process is clearly accelerated by a business downturn.

The record is clear: inflation and recession take a heavy toll on small businesses and on the economies of cities. The well-being of urban residents and also the ability of our families to become homeowners are both tied to the vitality of small businesses, a segment of the economy with extreme vulnerability to cyclical changes.

Therefore, while this Department has a direct concern with small businesses which are engaged in construction, repair, and rehabilitation, we are equally concerned with the impacts of inflation on the overall economics and fiscal health of cities. Inflation must be brought under control, and of course, cities must bear part of the burden. Our experience has shown that small business is vital to the well-being of cities, and vital to progress in areas of social concerns. Inflation and recession weaken small business, hurt our cities, and thwart our drive for greater social justice.

The Administration's efforts at reducing inflation are sensitive to the problems of small businesses and homebuyers. The Federal Reserve has specifically attempted to maintain reasonable availability of funds to these borrowers. Such a sensitivity will reduce the pain suffered not only by the housing sector but also by our declining cities during this period of complex economic forces and difficult but essential policy prescriptions. Reducing inflation today will promote a better economic environment for all households and firms in the long-run.

ATTACHMENT A

FEDERAL AGENCIES GOALS FOR AWARDS TO MBE IN 1980

(Expressed in millions)

Agency	1980 MBE goals: Contracts (over $10,000)	1980 MBE goals: Small purchases (under $10,000)	1980 MBE goals: Total goal
SBA negotiated:			
AID	22.1	0.2	22.3
DOC	43.2	4.3	47.5
DOE	198.0	1.0	199.0
DOL	40.0	.7	40.7
DOT	140.0	5.5	145.5
EPA	23.0	.5	23.5
GSA	196.0	1.5	197.5
ICA	.39	(1)	.4
NASA	117.0	1.5	118.5
NRC	.8	(1)	.8
State	1.8	(1)	1.8
TVA	56.6	1.4	58.0
Subtotal	839.9	16.6	856.5
OFPP determination:			
USDA	55.0	5.0	60.0
DOD	2,100.0	75.0	2,175.0
DOI	290.0	5.0	295.0
DOJ	7.4	5.6	13.0
HEW	106.0	10.5	116.5
HUD	32.0	1.0	33.0
Treasury	12.0	1.0	13.0
VA	146.0	36.0	182.0
Subtotal	2,748.4	139.1	2,887.5
All other (estimate)	56.0		56.0
Final total	3,644.3	155.7	3,800.0

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[1] Less than $100,000.

ATTACHMENT B

FEDERAL AGENCIES GOALS FOR AWARD TO SMALL BUSINESS IN 1980

Agency	(a) Total agency dollars contract over $10,000 (thousands)	(b) Percent of column (a) going to small business	(c) Total dollars of prime contracts which require subcontracting plans (thousands)	(d) Percent of column (c) to small business (including disadvantaged)
Interior	1,987,224	45.9	519,724	16.6
EPA	366,000	38.7	105,000	3.1
VA	1,700,000	46.0	444,900	75.0
USDA	1,524,961	68.0	189,100	13.6
AID	272,107	19.6	26,000	5.0
NASA	4,356,955	7.1	1,922,000	20.0
DOL	318,750	30.0	258,000	8.0
GSA	1,989,514	48.3	1,290,700	54.0
DOC	957,000	42.0	74,900	22.0
DOE	7,400,000	5.4	6,500,000	16.7
HEW	1,414,161	23.3	603,032	4.5
HUD	700,000	25.6	72,500	4.0
Justice	155,300	37.6	7,600	9.0
DOT	1,500,066	33.6	800,000	20.0
Treasury	270,000	16.5	73,000	2.0
ICA	35,000	20.7	2,000	10.0
TVA	1,925,000	37.0	900,000	10.0
DOD [1]	57,600,000	26.9	48,184,400	16.0

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[1] Interim goal. Further data is to be submitted by SBA and DOD.

Ms. Roistacher. I am happy to be here representing HUD. People may ask, what is HUD doing testifying on the issue of small business? I think it is very clear from the discussion that has gone on today in terms of the homebuilding industry, but as I continue with my testimony you will see that there is another major concern that we have.

Indeed, the Department has four levels of concern for small business. First, we are acutely concerned with the general health of minority and disadvantaged enterprises, and we are taking specific steps to address this concern.

Second, we are concerned with the health and viability of the many small firms in the housing sector.

Third, the Department is concerned with the viability of small businesses in urban areas. Stimulating and keeping small businesses viable is an important component of the Department's urban policy goals.

Finally, we are concerned with the general viability of small business in recognition of their important role in the economy. With respect to small business in general, you are well acquainted with their importance in terms of technological change and innovation—how important that is for productivity—and also the important employment impacts. One study before your committee reported that between 1969 and 1976, virtually all of the new jobs in the economy were from small business.

But small businesses are particularly fragile enterprises, as we have heard. Small businesses are not only especially vulnerable to an accelerating inflation, but also to restrictive credit and business downturns. And when we are talking about inflation and small businesses, we also have to think over the long haul in terms of business cycles in general and realize that there is some relationship between fighting inflation and a subsequent downturn in the economy. So my remarks will go beyond just the issue of inflation and the administration's policy and also address the potential problems from an economic downturn.

Small businesses are very sensitive to restrictive credit policies, and the gentlemen who all spoke before me have testified loud and clear on the serious problems of the credit squeeze that is currently before many small businesses.

In addition to just the cyclical problems, it is worth pointing out that there are secular patterns of industrial development which have been working against small businesses, especially with respect to financing arrangements which are a key, not only to the maintenance of ongoing production processes, but also to fostering research and development activities.

Your interest in small businesses comes at a time just after we have worked out, under Public Law 95–507, what our strategy will be within HUD in terms of trying to stimulate small and disadvantaged business. I have an attachment to my testimony which sets out what HUD's goals are. In order to achieve our goals, we have recently designated a director for the Office of Small and Disadvantaged Business Utilization. This office is currently in the process of defining its goals, and they are developing a program and putting together a staff.

Each program within the Department has prepared a specific plan for assisting minority and disadvantaged business. These plans are under review, but we think you will find that, while some of them need reworking, some of them are very, very innovative.

For example, in our housing office, we are reviewing plans which would encourage the economic development of small businesses through the use of local housing authority procurement.

In addition, we are considering setting aside a certain portion of modernization funds for small and disadvantaged businesses, perhaps up to 20 percent of our funds.

Although it is not fully operational, the Secretary has already given a number of assignments to the new Office of Small and Disadvantaged Businesses. In particular, he has asked this office to consider the use of Minority Enterprise Small Business Investment Corporations—MESBIC's—and joint ventures and other innovative arrangements in order to increase both the dollar amount and institutional impact of funds administered by our agency on small businesses.

In addition to the actions that HUD can take through its own procurement and program activities, our concern for small businesses extends to activities which are beyond our immediate control, and there are really basically two areas that I want to highlight. One is the housing industry, and the other is urban economies.

I will try to go quickly through my discussion of housing simply because you have heard a lot of testimony that alludes to that particular industry, and I will focus on what I feel are the strong links between the problems of small businesses, inflation, and urban areas.

Mr. LaFalce. Were you here this morning to hear the testimony of NAHB by any chance?

Mr. Roistacher. No. I did hear summaries of it, and I have seen some of the statements.

The housing sector is a sector which is heavily dependent on small businesses which are involved in both residential construction and rehabilitation activity. I want to emphasize that it is not just new construction but also rehabilitation that this Department is concerned with.

Housing construction involves many different kinds of businesses, and the great majority of these are small, even though there are firms of all class sizes involved in this sector. The average homebuilder employs 13 construction workers, and construction subcontractors average fewer than 10 employees. The housing industry also includes small firms engaged in housing repair as well as rehabilitation, and you have just heard how suppliers of materials to these firms are also very sensitive to whatever happens to the homebuilding industry, and many of these supplying firms are also small businesses.

I would like to distinguish between the long-term effect of inflation and the short-term effect, which includes costs incurred as we attempt to bring inflation under control.

Over a long period with steadily rising prices, both firms and households adjust to inflation by investing in assets that increase in value as prices increase. For consumers, home ownership has actually proved to be the most dependable way of doing this.

A low, steady rate of inflation, in which there is little uncertainty, has always been acknowledged as a healthy economic environment which promotes investment, growth, and a high standard of living. However, a rapidly accelerating inflation and the associated uncertainties that accompany this take a heavy toll on both households and firms. Accelerating and uncertain rates greatly increase the risks inherent in doing business.

For example, rapid increases in interest rates have had a direct impact on small business through increased costs, as you have just heard. This often hits small businesses harder than big businesses since the small businesses cannot rely on internal sources but really have to turn directly to lending institutions for their short-term capital needs—again, something which was clarified in the previous testimony.

Maintaining inventories costs more in such an environment, and fluctuations in both prices and sales can leave a business overextended. The sharp decline in housing sales, for instance, has left many builders with a huge unsold inventory of new homes which is being financed at construction loan rates exceeding 20 percent.

At the end of February, the homebuilders held an unsold inventory of 384,000 new homes, or more than 9 months' supply when a 6-month supply is usually considered normal.

We are concerned, not only with inflation and how it is currently affecting the housing industry, but also the companion issue, the anti-inflationary policy and the prospect of a downturn which is just beginning to appear.

High interest rates are one glaring result of inflation. As you are aware, efforts to fight inflation by tightening the availability of credit leads to even higher interest rates in the short run, as we have been experiencing in recent months. However, in the long run, we hope that such a policy will result in a lower rate of inflation and a more stable economic environment which will be good for business, especially for small business.

The high interest rates, however, have had and do have a disproportionate effect on housing construction due to the effects on the supply of both mortgage credit and due also to the impact on the most of borrowing, which currently has a dramatic impact on the demand for housing.

The problem faced by the housing sector today is less the availability of funds, which was a very serious problem in the past, and more the high cost of ownership and its translation into lower housing demand.

The current climate of high interest rates has clearly had a strong impact on housing. We just got the new housing start figures this afternoon. They were not available to you this morning. Let me just review that the figure in 1978 was above 2 million on an annual basis. The February starts figure was 1.33 million, and I am sorry to report that the figure for March was 1.04 million. We were expecting a drop, but it is a more dramatic drop than any of us had anticipated.

Mr. LaFalce. That is on an annualized basis?

Ms. Roistacher. Yes; 1.04 million is the annualized rate.

Mr. LaFalce. What were you projecting?

Ms. Roistacher. I think I would have looked more for something in the 1.2 area for this particular month. We were originally looking for something like 1.4 for the year, and it is much too early to tell what that final figure is going to look like until we see whether or not the anti-inflationary policy is able to have some impact and whether the housing sector is able to pick up toward the end of 1980.

Mr. LaFalce. The problem is not so much an availability problem as it is an affordability problem.

Ms. Roistacher. Yes.

Mr. LaFalce. Is that true not only nationally but also on a regional basis? For example, would that be true in the Northeast?

Ms. Roistacher. Well, there are regional differences, but they have been reduced by the preemption.

Mr. LaFalce. We just passed the preemption.

Ms. Roistacher. Yes. We have had the preemption since January, and so it is hard to judge its effect quite yet. Definitely, there are regional differences. The Northeast is very heavily dependent, for instance, on mutual savings banks.

Mr. LaFalce. It has not only been the usury question. There is also the question of the greater disintermediation.

Ms. Roistacher. That is right. And that is because the Northeast is more dependent on mutual savings banks.

Mr. LaFalce. That makes me ask the question again, did we have an availability problem in the Northeast?

Ms. Roistacher. I cannot say to you in the Northeast it is more an availability problem than a cost problem at this point, but I can say that in the Northeast the problem of availability has been bigger than the problem of availability elsewhere. But with preemption, there is a reduction in the availability problem.

For instance, I am in the process of trying to purchase in the Northeast, and I was just told—this was in the New York area—that I could get money but the money would be at 18 percent. So, the money was there, but it was just a matter of being at very high rates. At 18 percent the demand for housing tends to drop off.

Mr. LaFalce. Was that just the interest rate?

Ms. Roistacher. That was my interest rate.

Mr. LaFalce. You do not have any contacts in HUD to help you out?

Ms. Roistacher. No one has made me any generous offers.

Mr. LaFalce. That is just amazing.

What role has HUD had in discerning and trying to assist the problems of the financial institutions because of, say, the growth in money market funds, et cetera, as they might affect the viability of the thrift institutions and ultimately the small business people? It seems to me that HUD has not played an active enough role in expressing a voice regarding the financial markets and what is taking place there. They spend almost all their time discussing, "How are we going to spend the money that is appropriated by Congress for community development block grant moneys, section 8 programs, section 202, et cetera?" and not enough time and attention regarding the primary source of financial resources in the private sector.

Ms. Roistacher. I do not think that we spend all our time talking about one and not the other. Currently, we participate in a task force on thrifts and I think Mr. Villani——

Mr. LaFalce. How long have you had a task force on thrifts?

Ms. Roistacher. Let me have Mr. Villani who is very well versed on the institutional aspects of the finance industry give you some background on that.

Mr. LaFalce. Surely.

Mr. Villani. Congressman, I am Kevin Villani, and I am Ms Roistacher's assistant.

The task force that we are referring to is the recently created task force as a result of the recent bill.

Mr. LaFalce. How recently did you create that?

Mr. VILLANI. It is a 90-day study of the problem of thrift portfolios which is a part of the bill signed by the President on March 31, for the Depository Institutions Deregulation and Monetary Control Act of 1980.

Mr. LAFALCE. When were you formed?

Mr. VILLANI. In the last 2 weeks.

Mr. LAFALCE. When are you going to come out with your first study?

Mr. VILLANI. They will release the results within 90 days, which is the end of June.

Mr. LAFALCE. I will be interested in whatever data you have right now. So, if you could supplement your presentation today with whatever information you have regarding the financial viability of thrift institutions, particularly in the Northeast, which means particularly the savings banks—they are the biggest in the Northeast——

Mr. VILLANI. We would be glad to do that for the record, Congressman.

The FDIC was supposed to have been looking at that beginning late last December, with particular emphasis on mutual savings banks in the Northeast.

Mr. LAFALCE. Might they have some data that would be helpful?

Mr. VILLANI. They should. They are part of this task force process too.

Mr. LAFALCE. Who else is on the task force?

Mr. VILLANI. The Office of Management and Budget, the Council of Economic Advisers, the regulatory agencies, the Treasury, the Federal Reserve Board.

Mr. LAFALCE. Who chairs it?

Mr. VILLANI. It is chaired in the Treasury—Mr. Carswell.

Mr. LAFALCE. Mr. Carswell is chairing this task force?

Ms. Roistacher, let us talk about Brooke-Cranston. Does HUD favor activation of Brooke-Cranston?

Ms. ROISTACHER. I think HUD is very cautious at this point. It is clear that Brooke-Cranston will have a direct budgetary impact right now, and what we have to realize is that a very central part of the current anti-inflationary policy is to maintain budgetary restraint, and I think we have to be sensitive to that. While the housing industry is obviously in the midst of a serious downturn, the expectation is that markets will improve as the inflationary problem starts to settle down.

Mr. LAFALCE. But Brooke-Cranston is a countercyclical program. So if you say once the countercyclical program is not called for you will not ask for it, that begs the question: What are you going to do when you need it? Now is when you need it. To say, later on you will not need it, does not deal with the terrible dislocations.

Ms. ROISTACHER. I think it is a matter of being able to put the housing policy in the context of the overall anti-inflationary policy, and one of the things that is happening is that the Council is closely monitoring the housing market and, obviously thinks in terms of——

Mr. LAFALCE. Which council?

Ms. ROISTACHER. The Council of Economic Advisers.

Obviously, Brooke-Cranston is one of those tools that we are always looking at and thinking about, but we are not ready to come forward with it at this moment.

Mr. LAFALCE. It is going to take time to get passed; it is going to take time to get implemented. We are only going to be around to

October of this year. We will see a lot of homebuilders go under with different estimates—an 80-percent reduction in starts in one area. It will go down to 1 million annualized starts. It looks as if we will go below that in the future. It is going to have an inflationary impact later on with increased demand for housing that has to be met.

HUD itself has said that it is basically a low-cost program. HUD has testified to that. Certainly over a period of years, if not immediately, that will be so.

Were it not for the fact that you were part of the administration, you would speak with an independent voice. You would be standing on the rooftops shouting and yelling for the activation of Brooke-Cranston. Do you have any comment?

Ms. ROISTACHER. Again, I think there are troubles, but I think it has to be viewed within the context of an anti-inflationary policy.

I would like to say that we are looking at a number of options that will help homebuilders in the absence of a Brooke-Cranston program, and I would like to just mention that what we are looking at is revising the section 235 program so that it can have higher income and mortgage limits.

We are considering an increase in the income and mortgage limits and piggybacking it on to a GPM, which would essentially bring the initial payment down to what would look like an 8-percent initial level.

Mr. LAFALCE. Would that have less budgetary outlay than Brooke-Cranston?

Ms. ROISTACHER. Yes, it would—it depends on how much you do.

Mr. LAFALCE. Per unit?

Mr. VILLANI. Congressman, what we are looking to do is reorder the program so that, within the budgetary authority that has already been approved for that program, we would spend in a different way that would allow us to subsidize more units.

Mr. LAFALCE. Within the budgetary authority for 235?

Mr. VILLANI. The budget authority that has already been approved. We are looking at a way to restructure that so that it would apply to a great many more units than it currently can.

Mr. LAFALCE. Would that require any implementing legislation?

Mr. VILLANI. That is right. That is being discussed on the Hill.

Mr. LAFALCE. I am on the Hill, and I am on the Housing Subcommittee. Discuss it a little more with me. How would you—that would be required?

Mr. VILLANI. For one thing, there is an increase in the income limits. I believe it is an increase in eligibility to 120 percent of median income. There is also an increase in the mortgage limits that would be eligible.

Mr. LAFALCE. All you need is just to increase the limits?

Mr. VILLANI. We would increase the interest rate also. And there is some discussion about piggybacking a GPM program on this so that we can reduce the borrower's initial monthly payments even though the mortgage would have a higher effective rate.

Mr. LAFALCE. You have only got legislative authorization, say for 50,000 units of GPM, I think. That is the negatively amortized GPM that you only got 50,000 of?

Mr. **Villani.** Is that the new program? Under the existing 245, I do not think there is a limitation.

Mr. **LaFalce.** There is no outside limitation on the 245?

Ms. **Roistacher.** 245 is GPM.

Mr. **LaFalce.** That is the old GPM.

Mr. **Villani.** That is right.

Mr. **LaFalce.** Is there not any limitation on the total amount of GPM's that can be insured by FHA?

Mr. **Villani.** There was a restriction when the program was experimental, I believe.

Mr. **LaFalce.** OK. So we removed the restriction.

Mr. **Villani.** But there is also a restriction on this new program.

Mr. **LaFalce.** Yes—that I am aware of. That is 50,000.

I have one last question, Ms. Roistacher. NAHB is all upset about BEPS, saying it is inflationary and costly. There is a legislative mandate. Are you familiar with BEPS?

Ms. **Roistacher.** Yes.

Mr. **LaFalce.** That has to be promulgated by August 1980 and implemented with all new construction by August 1981. What do you think of the comments of NAHB that say we have a delay or moratorium?

Ms. **Roistacher.** I cannot estimate yet exactly what the cost is, but I understand that the BEPS standards are currently under review in terms of their actual cost impact, and without information—I would have to look at some detailed numbers to really respond.

Mr. **LaFalce.** Is it true that there has been no trial run of BEPS, other than through a computer?

Ms. **Roistacher.** When you say "no trial run," have the standards been built in?

Mr. **LaFalce.** No real life experience.

Ms. **Roistacher.** I do not think one could say that there is no experience. What you can do is, obviously, look at the standards as they have existed, not necessarily in one structure, but you could put them together and get some estimate of that, which is different from building everything in at once.

Mr. **LaFalce.** OK.

Thank you very, very much. We will excuse you, and we will go to COWPS.

Ms. **Roistacher.** Thank you.

Mr. **LaFalce.** Mr. Viscusi, we have had the pleasure in the past of having Barry Bosworth and Bob Russell, and I think this is your first appearance before the subcommittee, is it not?

TESTIMONY OF KIP VISCUSI, DEPUTY DIRECTOR, COUNCIL ON WAGE AND PRICE STABILITY

Mr. **Viscusi.** That is right, Mr. Chairman.

Mr. **LaFalce.** We welcome you here. We will introduce the entire text of your remarks into the body of the record and ask you to summarize, as you will. Without objection, it will be included at this point.

[Mr. Viscusi's prepared statement follows:]

PREPARED STATEMENT OF W. KIP VISCUSI, DEPUTY DIRECTOR, COUNCIL ON WAGE AND PRICE STABILITY

I am happy to be here to discuss the impact of inflation on small businesses. I will begin by summarizing the principal functions of the Council on Wage and Price Stability. These efforts affect the economic environment in which all firms operate. In addition, some of these activities are particularly pertinent to small businesses. After discussing the Council's operations, I will review the inflationary trends in the economy, noting any special matters of concern to small businesses.

The Council has two principal functions. The first involves administration of the wage-price guidelines. The intent of these voluntary standards is to elicit cooperation from industry in restraining wage and price increases. The second, more traditional function of CWPS is to assess the economic implications of economic policies and regulations.

In its wage and price guideline program, the Council has been responsive to the special needs of small businesses in several ways. Members of the CWPS staff meet periodically with representatives of small business groups. Most recently, I met yesterday with six small business representatives who discussed the impact of inflation and high interest rates. In addition, the Council has issued a special publication—"Pay and Price Standards: A Guide for Small Business"—designed to summarize the relevance of the guideline program to the small businessmen. In addition, the Council's reporting requirements and low-wage exemption tend to favor small businesses.

Since the inception of the guideline effort, small businesses have been exempted from all reporting requirements. Although the guidelines pertain to all enterprises, small businesses are not monitored and are not subjected to the paperwork and administrative costs associated with the program. During the first program year, all firms with less than $250 million in sales were exempted from the reporting requirement. In order to extend the scope of the program's coverage, the President's recently announced anti-inflation package expanded the reporting requirement to include all firms with sales of $100 million or more. Even with this expanded coverage, only the 2,500 largest enterprises are required to report wage and price data to the Council.

Small businesses were exempted in part because their cost of reporting appears to be particularly large relative to the benefits that would be derived from such information. Moreover, since small businesses tend to be concentrated in relatively competitive, nonunionized markets, the degree of the economic inefficiencies created by restraint of wage and price levels for small firms is likely to be greater than for larger enterprises.

The low-wage exemption provisions in the pay standard also benefit small businesses disproportionately since these firms pay lower wages on average, in part because they are less likely to be unionized. The low-wage exemption consists of two provisions. First, the pay standard exempts all employees whose pay was $4 per hour or less in straight-time hourly wages on October 1, 1978 and all workers hired since that time at a wage not exceeding $4 per hour. In addition, all employee units with an average straight-time hourly wage rate of $5.35 per hour or less during the third quarter of 1979 are exempt from the pay standard in the second program year.

One of the principal functions of CWPS is to assess the inflationary impact of government regulations. The CWPS Government Programs and Regulations group makes over 60 regulatory filings a year. Two principal themes of these filings are that competitive market forces should be encouraged and that regulations should not be adopted if they are not cost-effective or cost-beneficial. Efforts by the Council to promote efficient regulations promote the interests of all firms. In addition, many filings have a particularly beneficial impact on smaller enterprises. Below I summarize pertinent aspects of three recent filings.

In the Council's FAA filing (February 12, 1980), we urged that the FAA not require that small airplane operations be subjected to the same security requirements as domestic carriers. These requirements include x-ray screening and metal detectors, the hiring of specially trained security personnel, and the installation of enclosing fences. The Council concluded that the benefits of such a proposal would be quite low. There are very few hijackings of small planes, and it is doubtful whether the costs imposed by hijacking are as large as the costs of the FAA proposal.

In a DOL filing (February 27, 1980), the Council challenged the desirability of pension plan investment regulations that would reduce the supply of capital to small enterprises. The filing urged the Department of Labor to withhold final action on a proposed rule dealing with venture capital until DOL could provide a convincing analysis of costs and benefits.

Among the costs cited in the Council's preliminary analysis was the negative impact of the proposed regulation on small business, which is heavily reliant on venture capital. "Higher risk investments in small firms produce important innovations which may have 'external' benefits to the economy beyond the high yield to the firm. A subset of small growing firms has in the past been a source of important innovations. That small firms are perceived as a source of innovation is indicated by an announced Presidential policy to encourage the growth of small firms."

In its ICC filing on the intercity bus industry (January 7, 1980), the Council urged the ICC to reduce the barriers to entry in the intercity bus industry so that small firms could compete with the more established companies. "A small bus company need not be at a competitive disadvantage compared to a larger firm. Operation on a smaller scale can be and frequently is as (or more efficient than) large-scale bus operations. In summary, the intercity bus industry is not characterized by economies of scale that might provide a justification for regulation."

The Policy, Planning, and Evaluation unit of the Council is concerned less directly with the problems of small businesses. This group focuses more broadly on economic policies that affect inflation, which in turn influences the costs paid by small businesses for their productive inputs. Through its opposition to protectionist measures, the PPE group promotes the availability of the lowest-cost supplies and materials for small businesses. Other studies by this group, such as its analyses of oil industry prices and U.S. productivity trends, will benefit small businesses to the extent that they are affected by a sound anti-inflation policy.

The principal objective of all of the CWPS activities is to reduce the rate of inflation. As you know, the inflation rate accelerated during the early part of this year. The CPI rate of increase was at an annual rate of 17.2 percent for the three month period ending in February 1980.

Even more disturbing is the explosion in the underlying rate of inflation—a measure which reflects more accurately the portion of the economy influenced by the CWPS standards. The underlying rate excludes from the CPI the costs of food, energy, used cars, as well as the costs of home purchase, finance, taxes, and insurance. After exhibiting steady rates of increase in the 7 to 9 percent range throughout 1979, the underlying rate exploded to a value of 12.2 percent for the three months ending in February 1980. This pattern suggests that the increased costs of energy and housing are being transmitted throughout the entire economy.

This dramatic escalation in inflation prompted the development of an intensified anti-inflation program announced in mid-March. This program includes fiscal restraint through budgetary cuts, monetary restraint through credit controls, and direct wage and price restraint through an intensification of the voluntary guidelines program. The Council on Wage and Price Stability is expanding its staff and the scope of its monitoring effort in order to encourage voluntary wage and price restraint. In addition, meetings with key industry groups, such as industrial chemicals, are being held on a regular basis so that inflationary pressures in key sectors can be identified.

For these efforts to be effective, genuine restraint must be exhibited by all sectors of the economy, including small businesses. We have no evidence that the burden of these anti-inflation efforts is borne disproportionately by small businesses. Indeed, as I have already indicated, the CWPS reporting burdens fall exclusively on larger enterprises.

Similarly, there is no strong evidence that small businesses incur greater losses from inflation or would gain more from an effective anti-inflation policy. Perhaps the principal index of the impact of inflation is the energy-intensiveness of the firm, since energy price increases dominate the rates of inflation for all productive inputs. Although energy outlays as a percentage of sales decrease with the magnitude of total sales, this pattern may reflect the nature of the businesses in which small firms are engaged rather than the effect of firm size per se on energy utilization.

Even if small businesses are more energy-intensive, it is unclear whether any form of policy intervention is warranted. Energy conservation will not be at an efficient level if firms' energy purchases are subsidized in some way. Firms whose operations are no longer profitable given the increase in the relative price of energy should be permitted to cease operations altogether or to make other adjustments dictated by market forces.

If a major capital investment is needed to make the transition to a more energy-efficient technology, the firm may require external financing. These loans should be encouraged if one can distinguish firms that can make the transition to more efficient operations from those inefficient enterprises that will be driven out of business in the long run. As I indicated below, a monitoring issue of this type is raised with regard to all forms of financing efforts.

The evidence regarding the general availability of financing for small businesses is spotty, and the desirability of any additional intervention is unclear. Current restraints on credit will affect the availability of funds to all firms, including smaller enterprises. The financial pressures on small businesses could be alleviated through government guarantees of private loans to firms or additional financing of loans. It has been suggested that the recent bailout of the Chrysler Corporation establishes a precedent for such actions.

However, the Chrysler loan was distinctive in two major respects. First, this case raised broader economic policy issues relating to the structure of a major industry. Financial failure of the third largest automobile manufacturing corporation would have led to increased concentration in what is already a highly concentrated industry. If Ford and General Motors were the only major U.S. auto companies, the reduced competition in the market would have increased the burden placed on anti-trust policies.

A second distinguishing characteristic of the Chrysler policy is that the economic health of the industry was not in doubt. The principal need for the loan was to finance the retooling necessary to meet the changing demands stimulated by the increase in the relative price of gasoline and the imposition of various government regulations. The size of the company also facilitated the government's effort to monitor the use of the funds.

Loans to particular small businesses will not affect the character of the industry to the same extent since small business by their very nature tend to be more prevalent in industries that are not particularly concentrated. Even viewed on an industry-wide basis, it is doubtful whether loans to all small businesses seeking funds would have the same impact on the character of the industry as did the Chrysler loan.

An additional difficulty is that the task of assessing the desirability of making the loan and of monitoring the company's performance becomes considerably more severe once the number of companies eligible for loans proliferates. This problem is perhaps the central policy issue since ideally one would not wish to interfere with market pressures that drive inefficient firms out of business. Since temporary capital shortage problems cannot be readily distinguished from longer run inefficiencies, an expansion of financial aid to small firms runs the risk of supporting businesses that should be permitted to fail.

Expanded loan efforts consequently may thwart inflation objectives by subsidizing unproductive enterprises, further worsening the downward trend in productivity. Increased credit also would be stimulative, thus partially offsetting the beneficial effect that recently imposed credit restrictions will have on inflation.

These cautionary observations suggest that one should be careful in undertaking any substantial relief for small businesses. Before launching any major effort, more precise information is needed regarding the impact on small businesses of inflation and the anti-inflation program. Even if a potential problem is identified, the broader ramifications of any major policy change should be considered.

The Council on Wage and Price Stability will continue its efforts to restrain inflation and will maintain the emphasis of its current policies, which are particularly advantageous to small businesses. However, if inflation is to be restrained, some sacrifices on the part of businesses of all sizes will be required.

Mr. Viscusi. Mr. Chairman, I am happy to be here today to discuss the impact of inflation on small businesses. Since we are running late, I will confine myself to a brief overview of my comments.

As you know, the principal activity of our agency is the wage and price guidelines program. In administering this program, we are responsive to the needs of small businesses in several ways. Most important is that the guidelines themselves have two provisions of special interest to small businesses.

First, small businesses are exempted from all reporting requirements. They are not monitored, and they are not subjected to the paperwork and administrative costs of the guidelines. All businesses with sales of under $100 million or more are exempted from reporting.

Second, we have a low wage exemption provision that is particularly important to small businesses since these firms paid lower wages on average. The pay standard exempts from coverage all employees whose pay was $4 per hour or less in 1978 as well as all employee units with an average wage rate $5.35 per hour or less.

A second group of the Council that has an impact on small business is the Government Programs and Regulation Office which does all the regulatory filings. One of the regulatory filings coming up in the next couple of weeks is on BEPS (building energy performance standards), which you alluded to earlier.

The principal theme of these regulatory filings is that these regulations should be cost-effective and that their benefits should exceed their costs. I will mention three filings this year that will benefit small businesses if the positions that we have advocated in the filings are adopted.

First, in our FAA filing of February 12, we argued that small airplane operations should not be subjected to the same security requirements as domestic carriers. A second filing was with the Department of Labor, also in February. In that filing, the Council challenged a proposal by the Department of Labor to have pension plan investment regulations which would provide incentives for pension plans not to invest in venture capital. Since venture capital is a major source of funding for small businesses, which tend to be higher risk enterprises, we opposed this potential regulation.

Third, in an ICC filing, we urged that the ICC reduce the barriers to entry in the intercity bus industry so that small firms could compete with the larger firms.

In addition, in our research work in the Office of Planning Policy, and Evaluation, we look more broadly at economic policies that affect inflation, and these policies affect small businesses as well as large businesses.

Certainly, the overriding objective of the Council's activities is to reduce inflation. As you know, the rate of increase in the CPI was 17.2 percent for the 3-month period ending in February 1980. In this context, the real interest rate faced by people borrowing actually is quite low. For example, a 20-percent rate of interest is less than 3 percent in real terms. The relationship between inflation and interest rates is also evident in the recent drop in short-term interest rates, which I attribute to a decrease in the expected rate of inflation in the economy.

A particularly disturbing trend from our standpoint has been the explosion in the underlying rate of inflation. The underlying rate excludes from the CPI the costs of food, energy, used cars, as well as the cost of home purchase, finance, taxes, and insurance. The underlying rate increased at a rate between 7 and 9 percent throughout 1979, and for the 3 months ending in February 1980, it exploded to a value of 12.2 percent.

There has been a dramatic escalation in inflation that is spreading throughout the entire economy.

Mr. LaFalce. Let me just stop you for a second. That is really disastrous—an underlying rate of 12.2 percent.

Mr. Viscusi. We were shocked by it.

Mr. LaFalce. That is just disastrous.

One of the problems I have with the administration's anti-inflationary policies has been that they have always underestimated, it seems to me, the inflationary problems that we have been experiencing. So they have always had too little too late.

Mr. Viscusi. I think that is a problem, not only of the administration, but also of economists in general. Everybody underestimated the resiliency of the economy; everybody thought a recession was coming last year. So, I do not think it is the administration so much as the economics profession that was caught by surprise.

Mr. LaFalce. Help me understand inflation a bit better, if you will. I take it you are an economist?

Mr. Viscusi. Yes. I am on leave from Northwestern.

Mr. LaFalce. I, usually, when I am talking about inflation, would say there are a lot of different types of inflation. I think we could characterize it as demand pull, cost push, structural, and expectation. Would you care to comment on that categorization?

Mr. Viscusi. I am sure all those labels fit. I would prefer to highlight what I think are the two principal sectors causing inflation—the rapid increase in energy prices certainly is the greatest, and also the rapid increase in housing interest costs is the second increase.

What is happening now is that these increases are feeding throughout the entire economy as everybody tries to keep pace with inflation.

Mr. LaFalce. The underlying rate that you say is not attributable to the cost of home purchase—you are saying that is 12.2 percent?

Mr. Viscusi. That is right.

Mr. LaFalce. So you take that out of that 12.2 percent even though it might have had an impact in that 12.2 percent getting to 12.2. What would be the cause of the underlying rate of inflation?

Mr. Viscusi. Part of it is energy prices working their way through as inputs of various companies. We have begun a series of industry meetings. Last week we brought in the chemicals industry, and they were claiming that the rapid increase in chemicals prices was due in large part to the rapid increase in energy prices since petroleum is a major input into that industry. And I think there is a similar story for other industries.

Mr. LaFalce. Take the characterization I gave—demand pull, cost push, structural, and expectation. Our present inflation is probably a combination of at least some if not all. Which do you think would be the most serious cause of inflation today or source of inflation? I am not talking about energy, housing, food, medical care, et cetera. I know those have been definite sources. I am talking about the categories I have given you.

Mr. Viscusi. Certainly high demand is one thing.

Mr. LaFalce. Do you think that demand pull is a cause of today's inflation?

Mr. Viscusi. I do not think it is the major cause. Structural forces are things like housing and the energy. That is what I think would be the major causes.

Mr. LAFALCE. OK. What about cost push?

Mr. VISCUSI. That is what we are now getting in the underlying rate. These costs are then being generated throughout the entire economy.

Mr. LAFALCE. OK. What about expectation?

Mr. VISCUSI. That is partially what has kept the economy going. That is why we did not get the recession last year that everybody expected. Everybody kept spending money because they expected a high rate of inflation, and that is what has kept the economy moving.

Mr. LAFALCE. Would you say that the primary effect of balancing the budget, which is a cornerstone of the anti-inflationary policy, is primarily to cope with the expectational psychology?

Mr. VISCUSI. Clearly. I think you have hit the nail on the head in your earlier discussion.

Mr. LAFALCE. OK. Please continue.

Mr. VISCUSI. With this context of dramatically escalating inflation, the President's anti-inflation program was developed in mid-March. The program consists of three principal parts: Fiscal restraint through budgetary cuts; monetary restraints through credit controls; and direct wage and price restraint. For this last portion, the Council on Wage and Price Stability is currently expanding its own staff. We are beginning a series of meetings with key industry groups to identify inflationary pressures in key sectors and to discuss these problems with the industry.

For these efforts to be effective, genuine restraint must be exhibited by all sectors of the economy, including small businesses.

We as yet have no hard evidence that the burden of these anti-inflation efforts is borne disproportionately by small businesses. Indeed, as I have already indicated, our reporting burdens fall exclusively on larger enterprises.

Mr. LAFALCE. Which would enable you to have any evidence of the burden of the anti-inflationary efforts being borne disproportionately by small business?

Mr. VISCUSI. No, we do not——

Mr. LAFALCE. No wonder you do not have evidence if you have no mechanism for accumulating such evidence.

Mr. VISCUSI. I met with the same small businessmen you did today. I have met with them.

Mr. LAFALCE. The minutemen brigade?

Mr. VISCUSI. Yes.

What I urged the SBA to do is put together some hard numbers so that we could actually get a feel for the magnitude of the problem of small businesses versus those of large businesses, as opposed to focusing on isolated anecdotes, which is the type of evidence that we tend to get very readily for businesses of all sizes.

Mr. LAFALCE. The problem is that I do not know whether SBA has that data-gathering capacity. It seems to me that if you are going to do it, you are going to have to do it through the financial institutions.

Mr. VISCUSI. They claim they are going to come up with something.

Mr. LAFALCE. That is going to be very, very interesting.

Commonsense would seem to dictate to me the conclusion that they were correct—that there is a disproportionate burden. They have unique problems in comparison with larger businesses. They only have access to a certain type of financing through the private financial institutions. There is little place else they can go, and that is not true for big business.

Mr. VISCUSI. Certainly there is a strong possibility that small businesses have less of an opportunity to get funds.

Mr. LAFALCE. And they have less survival capacity, it seems to me, too. They cannot weather the storms as well as larger ones. And I do not think the administration has adequately considered the special plight of the small business community.

As a representative of COWPS, which I would hope has some input into the decisionmaking process, I would hope that you would give counsel that we have some special problems that small businesses have to cope with in order to survive both inflation and the policies to combat inflation. I think they are desperately needed, and I do not see anybody in this administration, curiously enough, considering those special needs.

Mr. VISCUSI. We are certainly eager to work with the Small Business Administration and Congress.

Mr. LAFALCE. OK. But it is not enough to just say, "Oh, we do not have reporting requirements for small business." We are not talking about the burden that COWPS imposes on small business; we are talking about COWPS taking the special needs of small business into consideration when they consider the total economy and give advice in the decisionmaking councils that exist, whoever they are.

Mr. VISCUSI. Here I am going to raise one cautionary note which relates to the task of assessing the desirability of making large-scale loans to small businesses. That is, ideally, one would not wish to interfere with market pressures which drive inefficient firms out of business.

Hopefully, a program can be designed, if one is designed, to distinguish temporary capital shortage problems from the other longer-run inefficiencies which also might appear in terms of a need for financial assistance.

In short, at the very least, I would urge that we should be very careful in undertaking substantial relief for small businesses, that we be cognizant of these types of problems, and that before launching any major effort or making any decision against any major effort, we acquire more precise information regarding the impact of inflation on small businesses.

In conclusion, let me note that the Council will continue its efforts to restrain inflation and will maintain the emphasis of our current policies which are particularly advantageous to small businesses. However, if inflation is to be restrained, some sacrifices on the part of all businesses will be required.

Mr. LAFALCE. I want to point out again the distinction between availability and affordability. I am not calling for an increase, for example, in the guarantee authority of SBA. I do not think they are reaching the authority they now have. That would go to the issue of availability. The problem is the issue of affordability; I am not talking about the marginal enterprises; I am talking about solid enterprises right now.

It seems to me that we ought to be considering some type of crash program. We have done it in the past historically for the homebuilding industry. That is what the Brooke-Cranston bill was all about in 1974. There have been a number of programs that have, basically, through one device or another subsidized interest rates for certain sectors of the economy.

I strongly suggest that until we are able to combat inflation and thereby bring down interest rates, we have to do something during this interim period. Otherwise, we are just going to have mammoth bankruptcies on our hands.

Unfortunately, the second bells have rung. I have now got about 9 minutes to get over to the floor to cast a vote. There are so many other areas that I would have enjoyed discussing with you.

Does COWPS become involved in consideration of the comparative inflation rates between the United States and other countries?

Mr. Viscusi. Yes; we are preparing a report on that right now.

Mr. LaFalce. I have difficulties with the methods that we use to judge inflation in the United States. I do not think the CPI is a very good index of inflation in the United States. I think the CPI that we use has a tendency to exacerbate inflation because of the automatic escalators that exist both in law and in contract, for example. But the President has not called for a remedy of that.

The Senate Budget Committee has not called for a remedy of that; the House Budget Committee has not called for a remedy of that; COWPS has not called for a remedy of that. I think you should; I think the President should; I think the Congress should. But you are the ones who can speak independently. You are the ones who are nonpolitical, allegedly. So, I think the harsher judgment should be cast upon you who are not so speaking out especially at a time when it is propitious to speak out because it is probably the only time you are going to get action on such a tough political issue as that.

Mr. Viscusi. Alfred Kahn did give testimony a couple of months ago where he urged that measures other than the CPI be considered, and he went through the problems of the CPI. At least we are cognizant of the problem.

Mr. LaFalce. Would you forward that to me?

Mr. Viscusi. Certainly.

Mr. LaFalce. Without objection, it will be included in the record at this point.

[Mr. Kahn's prior testimony follows:]

PRIOR TESTIMONY OF ALFRED E. KAHN

Mr. Chairman and members of the Inflation Task Force, I am happy to be here. It is clear from your excellent report of last fall that you stand out among all the branches and agencies of government in your understanding of our national inflation problem and in your resolution to combat it. I am delighted, therefore, to help you in every way I can.

It takes a special courage for a public official to question the accuracy of our most commonly used measure of inflation, the Consumer Price Index, or, as I have particularly and repeatedly, the validity of using it to index wages and benefits on the assumption that it measures changes in the cost of living. Uninformed critics will be quick to accuse the questioner of trying to tamper with the thermometer instead of curing the disease. Last week, for example, a columnist for the Baltimore Sun, wrote:

"Coach Kahn doesn't care how good the other team is, so long as he can keep score. And change the rules as he goes."

I will gladly leave it to you to judge whether I'm trying to tamper with the scoreboard or change the rules in the middle of a very serious game. I remind you, however, that the Bureau of Labor Statistics itself, which justly takes pride in its professionalism and insulation from political influence, has always stressed that the CPI is not and is not intended to be a measure of changes in the cost of living. Several years ago, indeed, it pointed out the peculiar problems associated with the home purchase and ownership components of the CPI and actually suggested various possible alternative ways of treating them. And, I am especially pleased to point out, just this past Monday, Commissioner Janet Norwood announced that the BLS would begin to publish five experimental indexes, each containing a different possible measure of the cost of homeownership.

In so doing, she emphasized, quite correctly, that "there is still considerable disagreement over the best method to measure homeownership," and at least by implication cautioned against making hasty changes in a measure so widely used as the CPI without careful review. For these reasons, I will not offer—I am indeed not in a position to offer—any specific replacement or substitute for the CPI.

But it seems to me unarguably important for us to understand now in what sense the CPI is misleading as a measure of the cost of living; why, specifically, its large housing component has in recent months seriously overstated the rate of inflation in a very important sense; and, even more damagingly, how this overstatement in the measure is itself demonstrably aggravating inflation—not just the measure of it but the actual, objective rate of inflation itself.

Let me elaborate this second point briefly; namely, that the way we measure inflation can itself aggravate inflation.

First, and most obviously, many of the prices we set and money incomes we receive in our economy are formally and regularly adjusted on the basis of changes in the CPI. To cite the most important examples of this indexing:

5.5 million workers covered by major collective bargaining agreements with "cost of living" adjustment clauses (COLAs);

2.2 million workers either organized in small unions or in non-union establishments;

35.1 million Social Security beneficiaries;

2.6 million retired military and Federal Civil Service employees and survivors;

0.6 million postal workers;

an unknown number of State and local welfare recipients;

an unknown number of those affected by movement of the "low income" threshold; and

an unknown number of those affected by rental, royalty, and child support agreements tied to the CPI.

The consequences of a change in the CPI on wages, benefits, the Federal budget and prices are, therefore, enormous. Take the case of Social Security. The Social Security Administration adjusts payments annually—in June—on the basis of first quarter to first quarter change in the CPI: in June 1979 this caused payments to be increased 9.9 percent; the dollar amount was about $9 billion. The purpose of the adjustment is, I presume, to assure that these benefits can command the same quantity of goods and services, the same standard of living, as a year earlier. I have no quarrel with that purpose. But if, as I will argue in a minute, the CPI has overstated the true cost of maintaining that standard of living by, say, two percentage points this past year because it overstated the cost of housing, this means benefit levels were increased or will be increased next time by some $2 billion too much. These overpayments show up, then, in the Federal Government's deficit, in the competition between the Federal Government and private borrowers in the capital market, and in the nation's Social Security tax bill, which in turn inflates business costs and prices.

In the same way, and even more directly, an overpayment for the same reasons to COLA beneficiaries under collective bargaining agreements quickly feeds back into the economy in the form of higher prices, which, of course, then raises the CPI further. In this way the CPI becomes, in effect, part of its own problem.

There are other, more subtle ways in which an overstatement of inflation in the cost of living in turn aggravates inflation. The changes in the wages of tens of millions of workers not themselves protected by formal COLA clauses are clearly influenced, in some degree, by the contract settlements and wage adjustments of major unions that do have this protection, and, even more broadly, by what workers and employers believe has happened to the "cost of living," which they typically measure by the CPI. Bear in mind, they have before them the practice of the government itself setting the pattern of using the CPI as the basis for cost of living adjustments.

Finally, and even more broadly, there is the role of inflationary expectations generally and the way in which they prove to be cumulatively self-justifying. If we think the rate of inflation jumped up last year from, say, 8 percent to 13 percent, and if that latter rate appears to be chronic and irreducible month after month, this is obviously going to have a general effect on our inflaitonary expectations, on our disposition to save—observe the almost unprecedentedly low levels of household savings in the last two quarters of 1979—on our willingness to borrow at higher and higher interest rates and to pay increasing prices for such assets as houses, all of which in turn accentuate inflation.

Before moving to take a closer look at the Consumer Price Index, I want to emphasize that there is no single "correct" measure of inflation. The choice and design of any particular index depends on what it is one wants to measure, and, second, on what use one intends to make of it. We cannot judge the CPI, therefore, except in terms of what it purports to measure and what it does not. My quarrel with that index, therefore, is in no sense a quarrel with the BLS, or even necessarily with the CPI as a measure of what it measures; it is, rather, its misinterpretation and misapplication that I want to underline.

All that the Consumer Price Index is and purports to be is a measure of what happens to the cost of buying a representative market basket of goods and services, whose composition is determined on the basis of periodic surveys of household expenditure patterns. The present most widely used index gives us the composite cost of purchasing a collection of goods and services representative of actual purchases by the "average" urban consumer in 1972–74.

This is a perfectly valid measurement to take. But observe that it raises at once a difficult definitional question: in 1972–74, many urban consumers bought stocks and bonds. These, being clearly not consumption goods, are not included in the index. But some of them also purchased houses; and these do enter the market basket; indeed, the costs of homeownership account for 25.6 percent of its total weight. Obviously, the purchase of a house is, in essence, an investment just like the purchase of a stock or a bond: one buys both in order to realize a flow of income in future years, as well as in hope that the asset will appreciate in value.

There is no simple answer to the question of whether it is correct or incorrect to include changes in the costs of acquiring assets in a Consumer Price Index. The market basket, for obvious reasons, includes automobiles, durable household goods, clothing, jewelry—all of which are assets in the sense that they will be consumed only over a substantial period of time, and may be acquired in varying degrees as an investment; yet few would deny that they are important components of the cost of maintaining a given standard of consumption. It is certainly arguable that the CPI—or some index of household expenditures—should measure the changing costs of all the goods and services households buy—durable and non-durable, whether properly regarded as consumption goods or long-term assets—with each component weighted in proportion to its relative importance in total household outlays in some base period.

At the same time, the question of whether "the Consumer Price Index" should include consumer durables becomes most acute when we are thinking of such long-lived assets as houses, and particularly in a period in which their acquisition has become increasingly attractive as a hedge against inflation—i.e., in expectation that their asset value will appreciate over time.

But, it might occur to one, if people do not consume houses, then surely they consume housing services; and surely the cost of housing, whether measured in terms of rents or the cost of acquiring a house, has been going up. Of course, no one denies that purchasing a house has become increasingly expensive. The problem is that an important part of that increased dollar cost of living has a counterpart: the dollar value of the housing services flowing from houses owned by people who bought them at various times in the past has also gone up correspondingly. The attempt to compensate people for the increased costs of housing, looked at from the cost side alone, will end up compensating them twice, because it fails to take into account the fact that they are also receiving income in the form of housing services whose money value has gone up equivalently.

This same observation applies to the attempt of some indexes—like the deflator of personal consumption expenditures in the GNP accounts—to handle this problem by pricing not the house itself or the costs of its acquisition, but its imputed rental value: what, they ask, has happened to the value of the housing services that a home owner consumes by living in his own house? There is a sense in which this increased rental value really does imply a rising cost to the home owner, since it measures what he or she could earn by renting out the house to others, instead of living in it.

But the inclusion of the changing rental value of owner-occupied houses in any price index falls prey to the same fallacy when the index it contains is taken as a measure of the cost of living. Just as what a home owner could get if he were to rent out his house goes up in a period of inflation, that is, just as this imputed "price" or cost of housing services to the home owner goes up, so too, exactly, does the money value of his real income. The homeowner who purchased a house before 1979 enjoyed the same real housing services throughout 1979 as in the year before at absolutely no increase in money cost, so far as the purchase price of the house and monthly mortgage obligations are concerned; and therefore, so far as this portion of his cost of living is concerned, he requires no indexation to maintain his previous living standard.

Moreover, the willingness of people in 1979 to incur sharply increasing mortgage interest rates and to pay higher prices for the houses they purchased—both of which are duly and heavily recorded in the CPI—were clearly motivated by an expectation that the money value of the assets they acquired in this way would continue to go up in the future.

That is why buyers are willing to incur mortgage obligations at 10, 11 and 12 percent rates of interest: as they view their investments, the real rate of interest is much lower than the nominal one, and the increase in their "cost of living" is balanced by the appreciating asset it has enabled them to acquire.

A smaller, but nevertheless still a large point: the CPI in recent months has been heavily affected by these sharply increasing interest rates. But the person who incurs these obligations takes heavily into account additionally the fact that those interest payments are tax-deductible: this means, again, that the CPI has exaggerated the real or net increase in his cost of living.

There is another way—indeed there are probably several ways—of looking at this particular defect of the CPI, as a measure of the cost of either consumption or of living. By its nature, the market basket includes only the costs of current purchases of houses and housing; there is no real place in an index that sets out to measure the changing cost from month to month of a market basket of consumption goods, weighted on the basis of the proportions spent on its various components in a base period, to show the unchanging outlays involved in continuing to pay for assets, like houses, that were acquired in the past. The CPI, therefore, does not reflect the fact that this very large component of the cost of living of scores of millions of American families has not changed in the last few years.

If 70 percent of my own particular cost of living went up at an annual rate of, say, 11 percent last year, while the 30 percent of my take-home pay that goes into mortgage payments on a house I bought in 1977 remained absolutely stable, then my total cost of living went up not by 11 percent but only by 7.7 percent.

I think it is very important to underscore that I am not, in these observations, criticizing the Consumer Price Index for including the costs of home purchases in, say, 1979 when only a small percentage of the population actually bought houses that year. That is not my point. Any index that attempts to measure the cost of a composite of purchases by a group of people, or for an "average" member of that group, will inevitably produce a misleading picture of what has happened to the costs of purchases by any individuals in that group the composition of whose purchases diverge from the average. The CPI in a year in which the price of beef has gone up unusually rapidly will overstate the increase in the cost of living for Hindus; but it will correspondingly understate the injury to the rest of the population. In a year like 1979 in which pork prices actually fell markedly, the CPI will understate the real income losses of orthodox Jews and Moslems; but it will correspondingly overstate the income losses of people on the other side of the average.

My point in the case of housing is a different one: by failing to take into account the fact that the purchasers of houses in 1979 were acquiring assets as well as consumption services; by failing to include in the "market basket" the unchanged mortgage obligations of people who had purchased houses in all the years before 1979; or, to put it another way, by failing to recognize that a large proportion of the population is not paying rent but is instead receiving housing services from houses it already owns, the CPI markedly exaggerated the increase in the cost of living of the average person, and of the American people collectively. And the groups of Americans who then had their money incomes indexed upward on the basis of the CPI, in order to compensate them allegedly for the increase in their cost of living, will on that account have ended up with a higher level of real satisfactions, the ability to command a larger number of goods and services than before, even if their consumption and expenditure patterns were exactly the same as the average reflected in the market basket.

I do not presume today to offer a solution to this problem. As I have already pointed out, the BLS has just this week published five experimental measures using alternative homeownership components. For the year ending November 1979 they show increases for that component alone ranging between 7.9 and 24.5 percent, as compared with the 18.3 percent in the present index; the overall CPI's incorporating these alternative homeownership measures range between 10.5 and 12.5, as compared with the 12.6 percent increase shown in the present index. The differences should be even larger in the last few months. If we were simply to exclude the costs of home purchase and financing, the CPI increase for this period would be 10.4 percent. This wide range of results does not prove the present index is wrong, or that any index will do just as well as any other. It merely shows, as I began this testimony by asserting, that one's choice and design of an index depends on what it is one wishes to measure, and for what purposes one wishes to use it.

Because of the complexity of this problem, the best course I think is for the Bureau and other experts to study these new series and attempt to reach a consensus about whether the Consumer Price Index itself should be changed, which of the other new indexes deserves consideration and further publicizing, and for what purposes each is best used.

While I have concentrated on the home purchase component of the CPI in my testimony today, I do want to call to your attention, briefly, a few other major aspects of what this price index measures and what it does not measure; and not all of them operate in the same direction.

One important limitation of the CPI as a measure of the cost of living is that, since, as I have already explained, it prices out a fixed market basket of goods and services whose composition is based on the actual pattern of consumer expenditures some time in the past, it fails to take into account shifts in the pattern of consumer purchases, and in particular shifts in response to changes in relative prices. Last year, as beef became scarce and beef prices went up sharply, people shifted to a greater relative consumption of chicken and pork. The CPI fails to take into account such shifts, and, therefore, tends to overstate the increase in consumer outlays—and, in some very real sense, in the price of what they buy. Since in general consumers will tend to reduce their purchases of the components of the market basket whose prices go up unusually rapidly, the composition of the basket, being based on a pattern of expenditures in the past, will tend systematically to give greater weight than consumers are giving currently to the products whose prices have risen most. During the last year, for example, the Department of Agriculture pointed out in early December, while the CPI food index went up at an annual rate of about 10 percent, consumers could fairly easily have held their spending on food roughly constant merely by shifts of this kind.

This particular limitation of the CPI is a little ticklish to interpret. On the one side, the ability of consumers to substitute other, less expensive and equally nutritious foods for the ones whose prices have risen so sharply clearly suggests that the increase in the CPI exaggerates the increase in their real cost of living. On the other hand, the necessity for shifting away from foods whose prices have risen most suggests that consumers suffered some decline in psychic income—some decline in their real standard of living—even though they were able in this way to hold their total outlays on food constant. The CPI, therefore, exaggerates the rise in their cost of living; the demonstration that consumers could have held their food outlays constant underestimates it.

Empirical studies by the BLS have apparently demonstrated that this particular distortion is of small importance. Whether that would be true in a period of sharp changes of relative prices such as occurred last year, I am not in a position to say.

On the other side, let me call briefly to your attention the fact that the CPI in no way reflects the tendency for the income tax rates people actually pay to drift upward during a period of inflation, as their money incomes rise. If we are going to change the CPI to a measure of the cost of living, ought we not reflect this increased burden of taxes? There is no simple answer to this question either: again, it depends on what one is trying to measure. A consumer price index, it may well be argued, should be concerned only with what happens to the prices of things consumers actually buy; what the government takes in taxes is a separate kind of decision, the effects of which are better recognized, as they are in fact recognized, in our statistics of household or personal disposable income. To turn to another use of the CPI, it would clearly be double counting on the one side to reflect this increasing tax take in our reported statistics of disposable income, as we do, and, in addition, to deflate the remainder, in order to get a measure of what has happened to real disposable income, by a price index that includes the increased burden of taxes.

As this last illustration in the use of the CPI suggests, once again, what index is the "correct" one depends upon the uses to which it is to be put. My main point is that use of the CPI to index money incomes in order to maintain real standards of living unchanged is a mistake so far as its treatment of homeownership is concerned; it overcompensates the beneficiaries for changes in their true composite cost of living, and to this extent aggravates inflation.

There are a couple of additional reasons for avoiding precipitous action in attempting to correct this misapplication of the CPI that I would like to call to your attention, in closing. One powerful consideration is that the use of this index for indexing is specified in a large number of private contracts, of which wage contractors are the most prominent. It is debatable whether it would be proper for the Government in effect to alter the terms of those contracts by changing the computation of the CPI itself. It is at least arguable, as a matter of economics, that other aspects of those contracts would have been different had it been known in advance that the CPI on which the indexing provisions were to be based would be differently computed. It would seem to make more sense for the Government to publish alternative indexes, with a clear explanation of what it is that each measures.

A shorter-run consideration is that while during the last year the CPI's treatment of homeownership has resulted in an exaggeration of the rise in the cost of living, when and if interest rates begin to go down, as they typically do in a period of decreasing economic growth or recession, the error will flow in the opposite direction: the increase in the CPI will be understated rather than exaggerated. To the extent that the former tendency has produced inequities and aggravated the cycle of self-justifying inflationary expectations, it would seem both inequitable and unwise not to profit from the compensating error that we hope lies ahead.

Needless to say, these short-range considerations in no way mitigate the desirability in the long run of correcting or supplementing the indicators that have such a powerful effect on our lives; and the time to start on the long run is now.

I hope you have found this discussion of a rather difficult subject instructive. Although I suspect I have told you all I know on the subject, I will be happy to try to answer whatever questions you may wish to pose.

Mr. LaFalce. Do you have any data regarding the criteria to determine inflation in the United States vis-a-vis the other countries of the world? I am fearful that I have been comparing apples and oranges when I look at the U.S. inflation rate and Germany's and Japan's and Argentina's rather than apples and apples. Do you have any studies on that?

Mr. Viscusi. I have the rates in front of me. It is a good question whether the rates are comparable.

Mr. LaFalce. Do you know if COWPS has done anything on that?

Mr. Viscusi. Certainly we can look into that.

Mr. LaFalce. I think it is a very interesting question. I would appreciate a written explanation of that.

Mr. Viscusi. We would be happy to.

Mr. LaFalce. Without objection, it will be included in the record at this point.

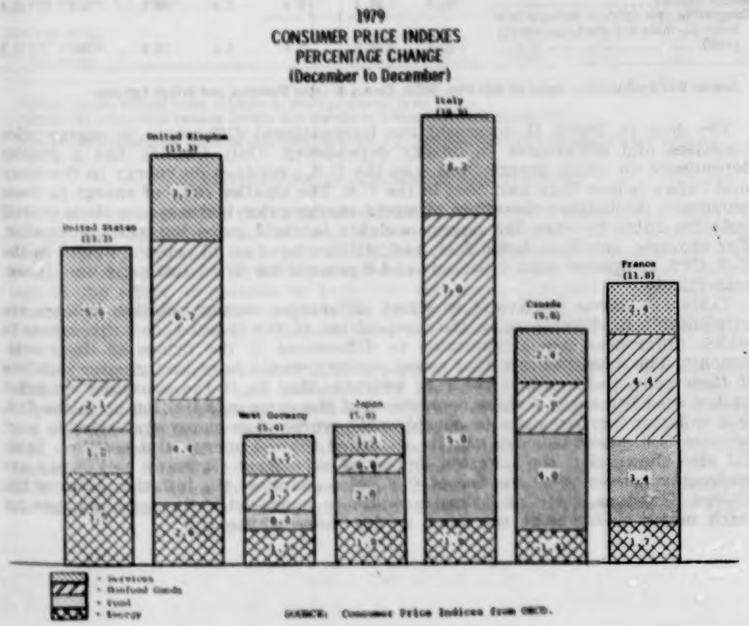
[COWPS international inflation comparisons follow:]

INTERNATIONAL INFLATION COMPARISONS

Much of the dramatic acceleration in the inflation rate during 1979 is attributable to a world-wide explosion of raw-material prices—especially crude-oil prices—and the transmission of these price increases throughout the economy. It has also been observed, however, that these shocks are not unique to the U.S., and that some countries—most notably West Germany and Japan—have had consistently lower inflation rates than the U.S. has had. On the other hand, other nations—such as the United Kingdom and Italy—have had greater inflation rates. Because inflation is a complex phenomenon with no single cause, there are many possible explanations for these international differences in inflation rates; a few are examined below.

A. CONCEPTUAL DIFFERENCES IN PRICE INDEXES

Figure I provides an overview of the levels of inflation (and the relative contributions of service, food, energy, and other components) in 1979 in seven major industrial countries, using each country's reported price index. Each index uses a different market basket, and there are conceptual differences as well. The most significant of these is that only the U.S. index includes both the costs of home purchase and mortgage interest. (The United Kingdom and Canadian indexes include mortgage-interest costs but not home-purchase costs; none of the others includes either costs.) Mortgage-interest costs account for 3.0 points of the 5.6-percentage point service component of the U.S. CPI increase. Because of this conceptual difference, the contribution to reported inflation of the services component for the U.S. exceeds that for other countries, both in absolute and relative terms.



SOURCE: Consumer Price Indices from OECD.

FIGURE 1

Table I shows comparable rates of change of consumer prices with the home-purchase and mortgage-interest-rate components removed where feasible. (The adjusted figures in the bottom line will be referred to as "comparable rates.") This adjustment reduces the U.S. inflation rate by 2.6 points, while the other countries' rates remain largely unchanged. It should be noted, however, that even this correction is only a partial adjustment for the different treatment of housing costs, because some of the countries exclude rental costs as well or have no housing component whatsoever.

B. DIFFERENCES IN ENERGY COMPONENTS

A second reason for the differences in recent inflation experiences is the differences in vulnerability to the explosion in energy prices. The U.S. has been especially vulnerable because of its greater energy dependence (not only do we use more energy than do other countries, but it is difficult to reduce our dependence quickly in response to price increases given that the economy's capital stock was developed on the basis of an expected continuation of low energy prices) and because energy prices have been increasing more rapidly in this country (in part because of the artificially low base cost of energy). Because of these factors, energy costs directly added 3.9 percentage points to the U.S. inflation rate, or over 2 points more than in those countries with low reported rates of inflation—West Germany and Japan.

TABLE I.—CONSUMER PRICE INDEXES: 1979

[Percent change]

	United States	United Kingdom	West Germany	Japan	Italy	Canada	France
Official measure	13.3	17.3	5.4	5.8	18.9	9.8	11.8
Comparable rate (official measure less home purchase and mortgage interest costs)	10.7	17.5	5.4	5.8	18.9	NA	11.8

Source: CWPS calculations based on data from OECD, Bureau of Labor Statistics, and British Embassy.

The data in Table II document the international differences in energy-price increases and differences in energy dependency. Only Canada has a greater dependence on oil or energy than does the U.S.; reliance on energy in Germany and Japan is less than half that in the U.S. The smaller roles of energy in these economies diminishes the effect of world energy-price increases on their overall inflation rates because the energy weights in their price indexes are smaller. For example, gasoline, home fuel, and utilities have an 11-percent weight in the U.S. CPI, compared with 7 percent and 6 percent for West Germany and Japan, respectively.

Table III shows the extent to which differences among inflation indexes are attributable to differences in the composition of the indexes, and the degree to which differences are attributable to differences in the prices of those components. The data indicate that every country would have had greater inflation if their price indexes had the U.S. weights—that is, if the consumer's market basket used for each of these countries had the same composition as in the U.S. Our inflation performance is considerably worse than many countries in part because U.S. purchases are heavily weighted toward energy and housing. Table III also shows that the inflation figures of only West Germany and Japan are noticeably worsened by the use of U.S. price changes; the inflation rates of the United Kingdom, Italy, and France would be improved if the price changes for each major sector were the same as for those of the U.S.

TABLE II.—COMPARISON OF INFLATION AND ENERGY DEPENDENCE, 1979

	Comparable price inflation	Energy price increase	Oil dependency[1]	Energy dependency[2] [3]	Ratio comparisons (United States = 1)			
					Price inflation	Energy inflation	Oil dependency	Energy dependency
United States	10.7	35.8	2.85	5.93	1.00	1.00	1.00	1.00
United Kingdom	17.5	26.6	1.62	3.55	1.64	.74	.57	.60
West Germany	5.4	21.4	1.28	2.38	.50	.60	.45	.40
Japan	5.8	29.0	1.87	2.59	.54	.81	.66	.44
Italy	18.9	27.4	1.98	2.96	1.77	.77	.69	.50
Canada	[4] 9.8	14.1	2.90	6.73	.92	.39	1.02	1.13
France	11.8	18.3	1.35	2.24	1.10	.62	.47	.38

[1] Oil dependency equals barrels of oil consumed per $1,000 (United States) of GNP.

[2] Energy dependency equals barrels of oil equivalent consumed per $1,000 (United States) of GNP.

[3] Energy requirements were constructed from 1978 OECD estimates of oil as a percent of total energy requirements for the major OECD members.

[4] Not strictly comparable because Canada does not include an interest component in its CPI.

Source: CWPS calculations based on data from CIA, International Energy Statistical Review; OECD, Economic Outlook July 1979; and OECD, International Energy Trends.

TABLE III.—COMPARABLE CONSUMER PRICE INDEXES: 1979

[Percent change]

	United States	United Kingdom	West Germany	Japan	Italy	Canada	France
Comparable rates[1]	10.7	17.5	5.4	5.8	18.9	[2] 9.8	11.8
U.S. weights, own prices	10.7	18.5	6.5	7.6	19.4	10.5	12.2
Own weights, U.S. prices	10.7	8.5	8.5	8.8	8.9	10.0	9.2
Difference using:							
U.S. weights	0	1.0	1.1	1.8	.5	.7	.4
U.S. prices	0	−9.0	3.1	3.0	−10.0	.2	−2.6

[1] Official indexes without home purchase or mortage interest costs.

[2] Not strictly comparable because Canada does include an interest component in its CPI.

Source: CWPS calculations based on data from OECD and U.S. Department of Labor, Bureau of Labor Statistics.

C. DIFFERENCES IN MACROECONOMIC POLICIES

It has been suggested that the international differences in inflation rates can be explained by differences in fiscal and monetary policies. Table IV provides some relevant data on such policies; although contemporaneous data on fiscal and monetary policies and inflation rates are not conclusive (because of complex lags in the effect of policies on inflation, structural differences between economies and changes in the composition of the money supply), the data in this Table suggest that the U.S. policies have not been overly stimulative (relative to other countries).

The Federal government deficit as a percent of GNP in 1979 was lower than that of West Germany and substantially lower than that of Japan; the rate of growth of the U.S. money supply was roughly equal to that of West Germany and substantially below that of Japan. Similarly the data on the relative tightness of the economies suggests that U.S. macroeconomic policies are not overly expansionary relative to other countries: The real rate of growth in the U.S. in 1979 was less than that of every other country except the United Kingdom; the unemployment rate was roughly double that of West Germany and Japan.

TABLE IV.—INTERNATIONAL MACRO COMPARISONS, 1979

	United States	United Kingdom	West Germany	Japan	Italy	Canada	Fran
Comparable inflation rate[1]	10.7	17.5	5.4	5.8	18.9	[2] 9.8	11.1
Percent in real GNP	2.3	−.3	4.3	6.3	[3] 4.0	2.9	3.8
Federal deficit as a percent of GNP	1.2	[3] 5.7	1.9	5.3	NA	4.5	NA
Percent change in money supply (M–1)	7.9	12.2	7.6	9.1	21.3	7.2	12.5
Unemployment rate[4]	5.8	5.8	3.0	2.1	3.9	7.5	6.1
Percent change in hourly wages[5]	9.2	14.9	6.5	6.5	20.6	9.6	11.5
Percent change in output per hour[5]	1.5	2.2	5.2	8.3	8.7	.8	5.4
Percent change in unit labor costs[5]	7.6	12.4	1.2	−1.6	10.9	8.7	7.1

[1] Official measure less home purchase and mortgage interest costs.
[2] Not strictly comparable because Canada does include an interest component in its CPI.
[3] Preliminary.
[4] U.S. concepts as calculated by the Bureau of Labor Statistics.
[5] Manufacturing.

Source: International Monetary Fund, Bureau of Labor Statistics, CIA.

D. DIFFERENCES IN PRODUCTIVITY GROWTH

The principal source of the better inflation performances of West Germany and Japan appears to be the much slower rates of growth of unit labor costs—1.2 percent in West Germany and minus 1.6 percent in Japan, compared to 7.6 percent in the U.S. This is, in turn, the result of two phenomena: lower rates of wage inflation and, more important, much higher rates of growth of productivity in those countries. The fact that these countries' wage increases are below the U.S. rates, and clearly not greatly in excess of the amount warranted by productivity growth, suggests that a key to reducing the long-run inflationary problem in the U.S. is revitalizing productivity growth and keeping wage increases in line with productivity advance.

Mr. LaFalce. I am going to miss that vote.

Does COWPS have any comment on the debt that the Federal Government now owes? Is that really a serious problem? I get contradictory remarks. For example, I hear of one set of statistics that the debt of the Federal, State, and local governments has really decreased over the years as a percentage of the GNP from 61 percent in 1960 to 53 percent in 1965 to 46 percent in 1970 to 44 percent in 1975 to 41 percent in 1979, whereas private debt has increased from 83 percent in 1960 to 94 percent in 1965 to 99 percent in 1970 to 105 percent in 1975 to 110 percent in 1979. It would tend to cast the private sector in the bad light as a debtor is concerned, because their debt has almost doubled while the debt of the Government of the United States is approximately 50 percent greater 20 years ago than it is today, at least as a percentage of the GNP.

Is that argument valid?

Mr. Viscusi. The crucial thing for the Government is not so much the level of the data as the stimulative effect of the current budget. If we had amassed a large debt for things we did 5 or 10 years ago, it would not have as large an impact on the economy as, let us say, running a deficit of $30 or $40 billion this year would have had.

Mr. LaFalce. OK. So you are saying that debts can be good or debts can be bad, depending on when you run that debt. Is that correct?

Mr. Viscusi. Yes; and the good thing is that it is an internal debt to the U.S. citizen, so it is not as if another country is going to call in a loan on us.

Mr. LaFalce. That is something else, too. Would you distinguish between gross Federal debt and net Federal debt?

Mr. Viscusi. I have no idea what the distinction is.

Mr. LaFalce. People refer to the debt that the Federal Government owes to itself as opposed to the debt that we would owe to bondholders, for example.

Does COWPS do any studying of the issue of when Government borrowing in the credit markets goes from a substitution for a lack of private sector borrowing to an actual crowding out of the private sector borrowing that exists?

Mr. Viscusi. We do not do any studies, but probably the best way to get a fix on it is to look at the pattern of interest rates and see what is happening there.

Mr. LaFalce. So you are suggesting that, as interest rates go up, that automatically means that the Federal Government is attempting to borrow money that otherwise would be borrowed by the private sector?

Mr. Viscusi. In general, these financial interest instruments can be viewed as substitutes from the standpoint of the people buying bonds. So that the greater you increase the supply of Federal bonds, the lower the price of bonds and the higher the interest rates, and that would have a ripple effect throughout the bond market.

Mr. LaFalce. Have you concluded your remarks?

Mr. Viscusi. Yes.

Mr. LaFalce. Because of the hour, regrettably, I am going to have to bring today's hearings to a close.

We will continue the hearings of the subcommittee tomorrow morning when we will have, among others, Mr. Fred Schultz, the vice chairman of the Federal Reserve Board. We will also have representatives of the Department of Agriculture and the Department of Commerce.

Thank you very much.

Mr. Viscusi. Thank you.

Mr. LaFalce. The hearing is adjourned.

[Whereupon, at 3:20 p.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

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IMPACT OF INFLATION ON SMALL BUSINESS

THURSDAY, APRIL 17, 1980

House of Representatives,
Subcommittee on General Oversight
and Minority Enterprise of the
Committee on Small Business,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:08 a.m., in room 2359-A, Rayburn House Office Building, Hon. John J. LaFalce (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN LaFALCE

Mr. LaFalce. The Subcommittee on General Oversight and Minority Enterprise will come to order.

This morning our subcommittee will continue its hearings investigating the impact of inflation and the administration's anti-inflation policies on small business. Yesterday our subcommittee heard testimony from several small business trade associations, from Citibank, from delegates to the White House Conference on Small Business, the Department of Housing and Urban Development, and the Council on Wage and Price Stability.

Their testimony revealed the plight of the small business community and the struggle to cope with the causes and effects of unprecedented inflation. Their testimony also pointed out that we lack a national strategy for small business to cope with inflation. The absence of such a strategy may very well threaten the survival of the small business community and thereby undermine our Nation's economy.

The witnesses appearing before us today represent the Federal Reserve Board, the Department of Agriculture, and the Department of Commerce. We hope that their testimony will contribute to the small business inflation dialog which eventually will result in some desperately needed solutions.

Before I call the Vice Chairman of the Federal Reserve Board to the table, I will comment on yesterday, especially in the presentation by the representatives of small business, especially those representatives who were elected by the White House Conference on Small Business. They considered a national crisis to exist of unprecedented proportion. They called themselves the minuteman brigade, perhaps to dramatize the urgency of the situation.

Yesterday in my opening statement and again in my conclusion I said that one of the defects we have had thus far is that we have not really had a national strategy for the small businessman to cope with inflation and to the problems that are caused by the anti-inflation policies that we have adopted. I support, in great part, the anti-inflationary policies that have been adopted thus far. But they are having their interim effect to the point where it is disastrous for small business. We have not developed a national strategy for small business to cope with these problems.

I think the problem is so great that I made the suggestion yesterday that we should change the name of the week coming up in May, the week of May 11, 12, 13, et cetera, from National Small Business Week to National Small Business Survival Week. I think that is what we are confronted with. When has small business ever had to contend with a prime rate of roughly 20 percent? Hopefully, it is going to be coming down. We had an encouraging sign yesterday. I think, with the monetary policies of the Fed, it will simply refuse to validate an inflationary rate that high. So, I think we will see a decline.

In the meantime, the effect of that might just be too late for the survival of more small businesses than have ever before fallen by the wayside, good small businesses. I think we have got to appreciate that fact and try to develop some policy to cope with it.

I am not sure if those policies can be within the ambit of the Federal Reserve Board, which will be our next witness; but, by the same token, I am aware of the tremendous powers that they do have under the 1969 Credit Control Act, which the President did trigger and call upon the Federal Reserve Board to implement. I will, during the question and answer period subsequent to the prepared testimony, explore the plenary power that exists within the Fed under that act and those alternatives that might be available to them and its contingency plans which they might have considered or might be considering to help small business through this especially difficult time.

With that, I would like to call the representative from the Federal Reserve, Mr. Fred Schultz.

TESTIMONY OF FREDERICK H. SCHULTZ, MEMBER, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. Schultz. Thank you, Mr. Chairman. Your remarks are quite accurate. Monetary policy is painful, particularly for small businesses.

We have spent a good deal of time talking about this particular problem and meeting with small businesses. I would like to respond to your remarks and, as we get into the questions and answers, perhaps to have a little dialog about some of the things that we have talked about.

I will this morning announce to you a new program. I will announce it to you in a general way. It will be given to the press somewhat later this morning, but I think we can discuss it in general terms.

I think the comments that I have in my prepared statement address some of your concerns in an orderly way. So, therefore, let me go through the statement. I think it will provide grist for further discussion.

[Mr. Schultz' prepared statement follows:]

PREPARED STATEMENT OF FREDERICK H. SCHULTZ, MEMBER, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

I appreciate the opportunity to appear before you today to discuss the difficulties that inflation poses for our economy and, in particular, for small businesses.

There is wide agreement in this country that inflation is our most serious economic problem. It is a problem that we have lived with for more than a decade. Even so, the difficulties encountered in adjusting to an inflationary environment, and the costs associated with these adjustments, make it clear that inflation is not a phenomenon that people can learn to live with comfortably.

Inflation breeds economic instability, especially when it accelerates unexpectedly, as it has in recent years. In such an environment, it is particularly difficult to interpret current market developments and plan and forecast future events. For businesses, earning a reasonable return on investment hinges on an ability to spot emerging trends in product demand, to utilize the most efficient method of meeting that demand, and to price products appropriately. Inflation alters spending and saving patterns, requiring businesses to adapt constantly to a varying economic environment. At the same time, the general rise in prices can obscure changes in price relationships and the underlying shifts in supply and demand that they signal.

Inflation impairs the ability of businesses to plan because future income flows are particularly hard to project when prices are being adjusted upward frequently. A major plant expansion, for example, would not be undertaken without some assurance that it would earn an adequate return over its lifetime. This calculation depends on predictions about the cost of the plant as well as the labor and materials used in the production process and the price and volume of its output. In an inflation these projections have a greater chance of being wrong. As a result, profits tend to be more variable, increasing the risks in any capital venture, and raising the rate of return that investors will require to finance it. For this reason, some investments that might have been undertaken in a stable price environment would not be attractive in an environment of inflation.

Indeed, even the measurement of income flows from capital investment is a difficult task in an inflationary environment. Under traditional accounting techniques, corporations value the materials and physical capital used in production at historical prices, which tend to fall increasingly below current costs of production during rapid inflation. The effect of this is to enlarge the reported profits of corporations and also the tax liabilities of these firms. The increase in profits, however, reflects capital gains on inventories and fixed assets rather than income generated from the operations of the firm. These capital gains must be reinvested by the firm if it wishes to maintain its productive capacity. The increased tax burdens associated with these gains, however, tend to reduce internal funds available to corporations.

Many of the problems associated with inflation seem especially acute for small business. Subject as they are to competitive forces, small businesses have little control over many of the factors affecting their profitability. As purchasers, they may lack the influence to make their suppliers absorb a portion of cost increases; as sellers, they may be less able than large businesses to pass through to consumers cost increases as they occur. Moreover, because of their dependence on outside suppliers, small businesses may have trouble anticipating cost increases. This can be especially troublesome when a business must sell products or services at prices contracted for several months in advance.

Dependence on a single or limited line of products increases a small firm's vulnerability to unexpected changes in product demand or production costs. Its size often precludes the flexibility to alter production or sales practices quickly in response to rapid changes in underlying supply and demand conditions. And it is less able to absorb losses that result from a bad guess or a purchase or contract that turns out to be unprofitable.

The financing needs of businesses are increased during an inflation as the dollar volume of transactions rises along with the price level. Moreover, the nominal cost of financing will rise as interest rates increase to compensate lenders for the declining value of the dollars they will be repaid. Small businesses can be especially affected by these developments.

Typically, they rely heavily on short-term funds, and thus their financing costs tend to escalate rapidly as inflation boosts interest rates. Rising interest charges may be particularly difficult to pass on in the price of output competitors are less dependent on short-term credit. Also, fluctuations in rates add an additional element of uncertainty to the planning process. We have heard from many small businesses over the last few years that inflation-enlarged interest expense has squeezed profit margins and deterred expansion. Moreover, most small businesses can not borrow directly in credit markets, and thus they are especially vulnerable to reduced credit availability at banks and other lenders on which they must rely.

I have only touched upon a few of the problems that inflation can cause for small businesses and others. They serve, however, to underscore the importance of a return to price stability. It is towards this goal that the Federal Reserve's recent actions have been directed. Last October, the Federal Reserve took steps to slow the growth of money and credit and to improve its ability to control future expansion of these variables. In February we announced to the Congress target ranges for the monetary aggregates in 1980 designed to produce an appreciable slowing of money growth and bank credit consistent with a move toward a noninflationary economy.

In the near term these actions, taken against a backdrop of strong credit demands, have raised the cost and reduced the availability of credit for all borrowers. Because such restraint works initially through the banking system, it may be having a disproportionate impact on small businesses and others who rely primarily on banks for funds.

Our March 14 initiatives were designed to spread the effects of credit stringency more equitably, as well as to reinforce our earlier actions. As part of the Special Credit Restraint Program, banks and finance companies are encouraged to "meet the basic needs of established customers for normal operations, particularly smaller business, farmers" and others "with limited alternative sources of funds". Moreover, the Board expects that in setting interest rates and other lending terms banks and finance companies will, where possible, take account of the special needs of these borrowers. At the same time, institutions are asked to avoid extensions of credit for speculative or nonproductive purposes or for purposes that may be financed from other sources. We are requiring reports from lenders so that we may monitor their efforts to meet our goals. Other parts of the March 14 program work toward assuring an adequate flow of credit to small businesses by discouraging certain types of consumer loans and by reducing the incentive for depositors to move funds from banks and thrifts into money market mutual funds.

There should be no illusions about this program, however. It cannot be used to isolate some classes of bank customers from the impact of tight money. The program must be viewed in the context of the Board's and the nation's overriding goal of reducing inflation. I might note that a greater degree of fiscal discipline would speed the return to more stable price behavior. Moreover, a reduction in federal borrowing would relieve some of the pressures on interest rates and free credit for use in the private sector.

The process of breaking the grip of inflation on our economy will not be a painless one. Nonetheless, the effects of inflation are so serious for small business and others that we must persevere on our current course. Delay will only increase the severity of inflation and the costs of eventually bringing it under control.

Mr. Schultz. Let me continue, Mr. Chairman, if I may, and outline a little bit of the program that we have in mind.

Mr. LaFalce. The program that you are going to announce today?

Mr. Schultz. Yes; that we will announce later this morning in detail.

We have become convinced that there is no way out of our current economic dilemma without a recession and that the sooner that we move through this very difficult period, the easier it will be, particularly on those who are especially burdened by the weight of monetary policy.

Monetary policy does not fall evenly across the economy, much as we may try to make it as equitable as possible. That, of course, is why a coordinated fiscal and monetary approach to the problem will work better because its effects can be spread more evenly across the economy.

We have been very aware of the problems caused by credit restraint in certain sectors of the economy, particularly in the areas of small business, of agriculture, and small financial institutions who have borrowed short and lent long.

Mr. LaFalce. Could I interrupt you at this point?

Mr. Schultz. Yes.

Mr. LaFalce. I know you have been aware of it. I recall right after October 6, when I was having breakfast with Paul Volcker and you joined us. It was within a day or so that you sent out a letter to the chief executive officers of every financial institution in the country urging them to give special consideration to the needs of the small business community, the agricultural sector, the housing industry, home buyers, et cetera, and adjusting their loan rates and also in avoiding speculative lending.

That was October. We did not have the 1969 Credit Control Act at that time triggered. On March 14, which is what you have made reference to today, you again say how on March 14, you encouraged the banks and financial communities pretty much to do the same thing that you encouraged them in that letter of October 24, as I recall.

So, thus far, all we have had is encouragement, which can be a strong thing if it is followed. Before you announce what you are doing in the new program, what have you done to monitor the voluntary compliance with your exhortations of October and March 14?

Mr. Schultz. Well, after the October steps were taken, when we did encourage them to be involved in some special programs for small business, we did survey a sample of banks and obtained reports on a number of banks that do have these programs. We have a list of some 110 banks that have special programs for small business.

I do not think that we know the total number of banks in the country that do have these programs.

Mr. LaFalce. I recall way back in 1973, 1974, 1975, when a great many banks had a so-called two-tier interest rate, a two-tier prime rate. But I do not think the practical effect of that was very much at all. I mean, I think it existed in reverse. I think there was a two-tier rate in the other direction in the United States of America: A lower one for your best customers, which are usually your biggest customers; and a higher one for your customers who were not quite as good, who were not prime. That was the two-tier system. I do not think it really has ever worked effectively in the other direction.

But, even if they say that they have a two-tier system that works to the advantage of the small business community, saying it and implementing it are two different things. I know banks that have that as a policy and do not implement it one iota, but it is pure PR.

So, my question is, What has the Federal Reserve done, not to get a list of the banks that say they have got a policy that gives special consideration for the small business community, but the actual monitoring of the performance of the financial institutions?

Mr. Schultz. In the first place, what you say has considerable validity, although my judgment is that more than half of the banks in the United States have a special program for small business. Most small banks deal almost entirely with small business, and in most areas of the country their rates tend to be lower than the prime. I am giving you purely anecdotal kind of evidence. I do not have any empirical evidence for this. It is just my judgment that more than 50 percent have lower primes for small businesses, but they are doing it really because they need to help their customers.

Mr. LAFALCE. Do you not think it would be good if the Federal Reserve attempted to accumulate some data that could permit them to speak with other than anecdotal data?

Mr. SCHULTZ. We are collecting that now.

Mr. LAFALCE. You are?

Mr. SCHULTZ. Yes.

Mr. LAFALCE. Would you tell me the type of information you are now collecting that will be of special assistance in determining how the small business community is being served and when you started gathering that data?

Mr. SCHULTZ. We announced it as part of the program on March 14. It was a system of reporting under the credit restraint program.

Those reports have started coming in. The first reports were due on April 10.

Mr. LAFALCE. What is in those reports that will be of special assistance in recognizing the problems of small business?

Mr. SCHULTZ. Among other things, the report says: Do you have a special program for small business? If so, describe it. If not, why not?

This comes in from all the banks that report both monthly and quarterly.

Mr. LAFALCE. That is not good enough. I mean, they are all going to come in and say: yes, we got a special program. They are going to give you a beautiful description. And it is not going to help us at all in determining how they are serving the needs of the small business community or how the small business community might be especially disadvantaged in this time of economic distress.

Mr. SCHULTZ. Well, it is a criminal act if they do not report accurately on these forms.

Mr. LAFALCE. It is not a question of reporting accurately.

Mr. SCHULTZ. I understand that.

Then the question becomes, how much money are they putting out under these kinds of programs. That, I think, is a more——

Mr. LAFALCE. You do not, by any chance, have a copy of the reporting requirements; do you?

Mr. SCHULTZ. We can certainly get it over to you.

Mr. LAFALCE. If you have it, I will take it now; if not, later.

[Reporting requirements referred to above follow:]

APRIL 18, 1980.

Hon. JOHN J. LAFALCE,
Chairman, Subcommittee on General Oversight and Minority Enterprise, Committee on Small Business, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: At yesterday's hearing before your Subcommittee you asked Governor Schultz to provide a set of the reporting forms under the Board's Special Credit Restraint Program.

I am pleased to enclose a set of the forms on behalf of Governor Schultz.

Sincerely,

JAY P. BRENNEMAN,
Special Assistant to the Board.

Enclosure.

FR 2061a
OMB No. 55-S-80001
Approved by Federal Reserve Board and OMB
March 1980

Base Report of Outstanding Covered Consumer Credit

This report is required by law (12 U.S.C. §§ 1901-1909, as implemented by Executive Order 12201).

The information provided by each respondent is regarded as confidential. If it should be determined subsequently that any information collected on this form must be released, respondents will be notified.

PLEASE READ INSTRUCTIONS PRIOR TO COMPLETION OF THIS REPORT

Section 1: Name and Address of Respondent Company

Name ______________________ Address ______________________

Section 2: To be Completed by Institutions Whose Covered Credit is Included in the Base Report Filed by Another Office.

If the amount of your covered consumer credit outstanding during the base period is included in a report submitted by or on behalf of your parent company, you should not complete SECTION 3 of this report. Rather, please check this box, complete Items 2a and 2b below, sign this report, and return it to the institution designated below. ☐

2a. Name and address of parent company

Name ______________________ Address ______________________

2b. Name and address of the reporting office filing the combined report (if same as Item 2a, enter "same")

Name ______________________ Address ______________________

Section 3: To be Completed by Institutions Whose Covered Credit is Not Included in the Base Report Filed by Another Office

3a. Is your institution filing this report on behalf of other offices? Yes ☐ No ☐

If yes, please provide the name and address of the parent company (if same as the name and address shown in SECTION 1 above, enter "same").

Name ______________________ Address ______________________

3b. If the amount of your covered consumer credit outstanding during the base period was less than $2 million, you should not complete Item 3c. Rather, please check this box, sign this report, and return it to the institution designated below. ☐

Otherwise, please complete Item 3c.

	Bils.	Mils.	Thous.
3c. Amount of covered consumer credit outstanding during the base period			

NOTE: The Base for the Special Deposit Requirement is Either (1) the Amount Shown in Item 3c Above or (2) $2 Million, Whichever is Larger.

FR 2081a
page 2

I certify that the information shown on this report is correct.

Authorized Signature

Title

Area Code and Telephone Number

This report must be filed no later than April 1 with the institution designated below.

All members of the Federal Home Loan Banks and all other savings and loan associations should return this report to the Federal Home Loan Bank.

All credit unions should return this report to the Central Liquidity Facility of the National Credit Union Administration.

All other creditors should return this report to the Federal Reserve Bank in whose District the respondent company is located.

PENALTIES. For each willful violation of 12 C.F.R. 229 Subpart A, the Board may assess against any creditor, or officer, director or employee thereof who willfully participates in the violation, a maximum civil penalty of $1,000. In addition, a maximum criminal penalty of $1,000 and imprisonment of

INSTRUCTIONS

Who Must Report

This report is required from each U.S. creditor with covered consumer credit outstanding of $2 million or more during the base period. This base report may also be required of certain other creditors.

For purposes of reporting and determining whether the creditor's outstanding covered credit is $2 million or more, the covered credit of all U.S. offices of the same company and all direct and indirect U.S. subsidiaries of the same parent company shall be combined, and only one report shall be filed for the combined organization. Any office may be designated as the reporting office for the combined organization. (However, once a reporting office is designated, it should not be changed without prior notification to the institution receiving the report.)

For example, if a company has 100 offices throughout the U.S., it should combine the required information from each office, and one designated reporting office should file one combined base report for the entire company.

The covered credit of all U.S. offices (such as the branches, agencies, and subsidiaries, including banks) of the same foreign parent company and all U.S. offices of that foreign parent's non-U.S. subsidiaries shall be combined, and one office selected as the reporting office for such offices. A subsidiary is a company that is more than 50 percent owned, directly or indirectly, by another.

Purpose of the Report

In accordance with the Credit Control Act (12 U.S.C. §§ 1901-1909) as implemented by Executive Order 12201, the Board of Governors of the Federal Reserve System has adopted provisions requiring certain creditors that extend certain types of consumer credit to maintain a special noninterest-bearing deposit with the Federal Reserve against increases in the amount of those types of credit outstanding.

The base for the special deposit requirement calculation for each creditor will be determined from this report. If daily data are available, a creditor shall report as its base the actual amount of covered credit outstanding on March 14, 1980 or the last day before March 14 for which such data are available. If daily data are not available, the creditor shall report as its base the amount of such credit outstanding during the last period immediately before March 14, 1980, for which such data are available.

Any covered creditor with covered credit outstanding of over $2 million on an average basis during a calendar month is required to maintain a special noninterest-bearing deposit with the appropriate institution designated below. The special deposit requirement is 15 percent of the amount by which the amount of covered consumer credit on an average basis during the computation period exceeds the reported base or $2 million, whichever is greater. The first computation period shall cover the period beginning March 15, 1980, and ending April 30, 1980. Thereafter, each computation period, or reporting month, shall begin on the first day of each month and end on the last day of that month.

The special deposit requirement must be maintained during the period beginning on the fourth Thursday of the month following the computation period (or reporting month) and ending on the Wednesday before the fourth Thursday of the next month. For example, the special deposit required for the first computation period (March 15 through April 30) shall be held beginning Thursday, May 22, 1980 and continue through Wednesday, June 25, 1980. A new special deposit amount based on the May report will then be required beginning Thursday, June 26, and will continue through Wednesday, July 23. The amount of the special deposit may not vary during each maintenance period.

The special deposit shall be maintained in collected funds in the form of U.S. dollars.

Members of the Federal Home Loan Banks and all other savings and loan associations shall maintain the special deposit with the Federal Home Loan Banks. All credit unions, whether or not members of the National Credit Union Administration's Central Liquidity Facility, shall maintain the special deposit with the Central Liquidity Facility. Deposits maintained with the Federal Home Loan Banks and the Central Liquidity Facility shall be passed through by those entities to the Federal Reserve Banks. All other covered creditors, including commercial banks, mutual savings banks, U.S. branches and agencies of foreign banks, retailers, other credit card issuers, and finance companies, shall maintain the special deposit with the Federal Reserve Bank in whose District the reporting office is located.

Where and When to Report

The base report for all creditors shall be filed by no later than April 1, 1980. The first monthly report (covering the period beginning March 15 and ending April 30) shall be filed by May 12. Thereafter, each monthly report shall be filed by no later than the second Monday following the reporting month.

Members of the Federal Home Loan Banks and all other savings and loan associations should file their reports with the Federal Home Loan Bank where the deposit will be maintained.

All credit unions should file their reports with the Central Liquidity Facility of the National Credit Union Administration.

All other creditors should file their reports with the Federal Reserve Bank in whose District the reporting office is located.

How to Report

All amounts should be reported to the nearest thousand dollars.

Amounts of covered consumer credit outstanding denominated in foreign currencies should be valued in U.S. dollars at the prevailing exchange rate at the time the transaction originally is entered into.

General Definitions

Base: The larger of $2 million or the amount of covered credit outstanding as of the close of business on the base date.

Base date: For a creditor that has daily credit data available, March 14, 1980, or the last day immediately before March 14, 1980 for which such data are available; for a creditor that does not have daily credit data available, the period immediately before March 14, 1980 for which credit data are available.

Board: The Board of Governors of the Federal Reserve System.

Closed-end credit: All consumer credit except open-end credit.

Consumer credit: Credit extended in the U.S. primarily for personal, family, or household purposes. Credit extended for business or agricultural purposes is excluded.

Covered credit: Consumer credit that is (1) open-end credit and (2) closed-end credit which is unsecured or in which the proceeds of the credit are not being used to purchase the collateral. Covered credit that is sold or otherwise transferred after March 14, 1980 to any office located outside the U.S. of the same or another entity shall remain the covered credit of the transferor until such credit is repaid. Covered credit that is sold or otherwise transferred on a recourse basis to any U.S. office of the same or another entity shall remain the covered credit of the transferor; covered credit that is transferred on a nonrecourse basis to any U.S. office of the same or another entity shall be treated as covered credit of the transferee.

Covered credit does not include insurance company policy loans; credit extended by federal, state, or local governments, or by providers of utility, health, or educational services; state or federal government guaranteed loans; or loans secured by savings deposits [1] held at the lending institution.

Covered creditor: Any creditor which extends covered credit. For purposes of determining the amount of a creditor's outstanding covered credit, the covered credit of all U.S. offices of (1) the same company, (2) U.S.

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[1] As defined in § 217.1(e) of Regulation Q.

subsidiaries of the same parent company, and (3) non-U.S. subsidiaries of the same parent company shall be combined. A subsidiary is a company that is more than 50 percent owned, directly or indirectly, by another company.

Credit: The right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment.

Credit transaction: See "Extension of credit."

Creditor: Any person who extends, or arranges for the extension of, credit, whether in connection with a loan, a sale of property or services, or otherwise.

Extension of credit (or "credit transaction"): Loans, credit sales, or other supplying of funds.

Loan: Any type of credit, including credit extended in connection with a credit sale.

Open-end credit: Consumer credit extended on an account pursuant to a plan under which (1) the creditor may permit the customer to make purchases or obtain loans, from time to time, directly from the creditor or indirectly by use of a credit card, check, or other device, as the plan may provide; (2) the customer has the privilege of paying the balance in full or in instalments; and (3) a finance charge may be computed by the creditor from time to time on an outstanding unpaid balance.

Subsidiary: Any company in which more than 50 percent of the outstanding voting stock is owned directly or indirectly by another.

U.S.: The 50 states of the United States and the District of Columbia.

Non-U.S.: Any geographic area located outside the 50 states of the United States and the District of Columbia. Thus, for purposes of this report, non-U.S. includes Puerto Rico and U.S. territories and possessions.

Examples

As noted above under "General Definitions," covered credit consists of (1) all open-end consumer credit, whether secured or unsecured, and (2) closed-end consumer credit that is either unsecured or secured by collateral that is not being purchased with the proceeds of the credit.

Examples of open-end credit that is covered are:

- Credit card plans, such as cards issued by financial institutions, retailers, and oil companies.
- Overdraft and special check-type plans offered by financial institutions.
- Other revolving credit plans.

Examples of closed-end consumer credit that is covered are:

- Unsecured personal loans.
- Loans for which the collateral provided is already owned by the borrower.
- Open account and 30-day credit without regard to whether a finance charge is imposed, such as travel and entertainment card plans and retail merchant credit.
- Credit secured by financial assets, other than savings deposits, when the collateral is not purchased with the loan proceeds.

Credit extended through the use of credit cards will be presumed to be consumer--that is, non-business--credit unless the creditor establishes otherwise.

A creditor will also be required to treat as covered consumer credit any such credit that is sold or otherwise transferred to any non-U.S. office of the same or another entity and any such credit that is sold or otherwise transferred with recourse to another entity, wherever located.

Examples of consumer credit that is not covered are:

- Secured credit where the collateral is purchased with the proceeds of the loan, such as automobile, mobile home, and other chattel-secured loans (see Uniform Commercial Code § 9-107, including Official Comments 1 and 2).
- Credit secured by financial assets when the collateral is purchased with the proceeds.
- Credit secured by savings deposits held at the lending institution.
- Mortgage loans where the proceeds are used to purchase the collateral or for home improvements or "bridge" loans.
- Insurance company policy loans.
- Credit extended by providers of utility, health, and educational services.
- Credit extended under state or federal government guaranteed consumer loan programs, such as student loans.

Instructions

Include all covered consumer credit that is on the creditor's books that is not actually written off, even if during the reporting period the credit is past due and collection is doubtful. Also, report the aggregate book value of covered credit net of unearned income and before deduction of allowance for loan losses. Depositary institutions should report covered credit outstanding net of deposits accumulated for the payment of personal loans (hypothecated deposits).

Each creditor should include the amount of its share of participation loans, including participations in pools of loans, if such loans meet the definition of covered credit. Participation loans are loans made in cooperation with other financial institutions. The creditor should report only the dollar amount outstanding of its share of the participation loans even if it is the "lead" institution in the participation arrangement.

Participations in pools of loans are described as follows: (1) A "pass-through" participation, when issued by a bank or other private institutions, represents a pro-rata share in the pooled loans. In this case, the terms of the participation (e.g., maturity, interest rate, etc.) are identical to the terms of the underlying loans. Consequently, the issuing institution incurs no obligation other than to pass on proportional shares of whatever payments of principal and interest are collected from the obligors of the underlying assets in the pool. The creditor purchasing such a participation should report the underlying loans as covered consumer credit. (2) In other types of participations (i.e., those other than "pass-through" participations), the instrument of participation bears terms (e.g., maturity, interest rate, etc.) that differ from the terms of the loans comprising the pool. Consequently, the institution issuing the participation does incur an obligation on the instrument of participation itself. A creditor issuing these participations should report the underlying loans as covered consumer credit.

FR 2061b
OMB No. 55-R-0270
Approved by Federal Reserve Board and
OMB March 1980

Monthly Report of Covered Consumer Credit Outstanding Subject to Special Deposit Requirement

As of ______________________________

This report is required by law (12 U.S.C. §§1901-1909, as implemented by Executive Order 12201).

The information provided by each respondent is regarded as confidential. If it should be determined subsequently that any information collected on this form must be released, respondents will be notified.

PLEASE READ INSTRUCTIONS PRIOR TO COMPLETION OF THIS REPORT

	Bils.	Mils.	Thous.
1. Average amount of covered consumer credit outstanding during the reporting month . . .			
2. *Base:* Amount of covered consumer credit outstanding during the base period or $2 million, whichever is larger			
3. Amount by which the average amount of covered consumer credit outstanding during the reporting month exceeds the base (Item 1 minus Item 2)			

If Item 3 is zero or negative, no special deposit is required during the maintenance period. Please sign below and return this form to the institution designated below.

If Item 3 is greater than zero, a special deposit is required during the maintenance period. Item 4 must be completed for calculation of the special deposit requirement.

	Bils.	Mils.	Thous.	Hunds.
4. 15% of Item 3: **Special noninterest-bearing deposit required to be held during the maintenance period.** (NOTE: Report this amount in *dollars*.)				

MEMORANDA

1. Amount of covered consumer credit sold or otherwise transferred to non-U.S. offices of the same or other institutions (must be included in Item 1 above).			
2. Amount of covered consumer credit sold or otherwise transferred with recourse to U.S. offices of the same or other institutions (must be included in Item 1 above)			
3. Amount of covered consumer credit sold or otherwise transferred without recourse to U.S. offices of the same or other institutions (must *not* be included in Item 1 above) . . .			
4. Amount of covered consumer credit purchased without recourse from U.S. offices of the same or other institutions (must be included in Item 1 above).			

METHOD OF ACCOUNTING

Data on covered consumer credit are maintained on the following basis (check one):

☐ Daily
☐ Other (please specify) ______________________________

This report reflects data computed on the following basis (check one):

☐ Daily
☐ One-day (please specify the date) ______________________________

☐ Other (please specify) ______________________________

NOTE: If your institution maintains data on a daily basis, you must report on a daily average basis.

FR 2081c
Page 2

I certify that the information shown on this report is correct.

Authorized Signature

Title

Area Code and Telephone Number

Name of Respondent

Address

City, State, and Zip Code

Please return by the second Monday of the following month, as follows:

All members of the Federal Home Loan Banks and all other savings and loan associations should return this report to the Federal Home Loan Bank.

All credit unions should return this report to the Central Liquidity Facility of the National Credit Union Administration.

All other respondents should return this report to the Federal Reserve Bank in whose District the reporting office is located.

PENALTIES. For each willful violation of 12 C.F.R. 229 Subpart A, the Board may assess against any creditor, or officer, director or employee thereof who willfully participates in the violation, a maximum civil penalty of $1,000. In addition, a maximum criminal penalty of $1,000 and imprisonment of up to one year may be imposed for willful violation of this subpart.

INSTRUCTIONS

Who Must Report

This report is required from each U.S. creditor with covered consumer credit outstanding of $2 million or more either during the base period or, on an average basis, during any subsequent calendar month.

For purposes of reporting and determining whether the creditor's outstanding covered credit is $2 million or more, the covered credit of all U.S. offices of the same company and all direct and indirect U.S. subsidiaries of the same parent company shall be combined, and only one report shall be filed for the combined organization. Any office may be designated as the reporting office for the combined organization. (However, once a reporting office is designated, it should not be changed without prior notification to the institution receiving the report.)

For example, if a company has 100 offices throughout the U.S., it should combine the required information from each office, and one designated reporting office should file one combined monthly report for the entire company.

The covered credit of all U.S. offices (such as the branches, agencies, and subsidiaries, including banks) of the same foreign parent company and all U.S. offices of that foreign parent's non-U.S. subsidiaries shall be combined, and one office selected as the reporting office for such offices. A subsidiary is a company that is more than 50 percent owned, directly or indirectly, by another.

Purpose of the Report

In accordance with the Credit Control Act (12 U.S.C. §§ 1901-1909) as implemented by Executive Order 12201, the Board of Governors of the Federal Reserve System has adopted provisions requiring certain creditors that extend certain types of consumer credit to maintain a special noninterest-bearing deposit with the Federal Reserve against increases in the amount of those types of credit outstanding. This report is used to compute the special deposit requirement.

Any covered creditor with covered credit outstanding of over $2 million on an average basis during a calendar month is required to maintain the special noninterest-bearing deposit with the appropriate institution designated below. The special deposit requirement is 15 percent of the amount by which the amount of covered consumer credit on an average basis during the computation period exceeds the creditor's reported base or $2 million, whichever is greater. The first computation period shall cover the period beginning March 15, 1980, and ending April 30, 1980. Thereafter, each computation period, or reporting month, shall begin on the first day of each month and end on the last day of that month. Thus, for example, the computation period for May will begin on May 1 and end on May 31.

The special deposit requirement must be maintained during the period beginning on the fourth Thursday of the month following the computation period (or reporting month) and ending on the Wednesday before the fourth Thursday of the next month. For example, the special deposit required for the first computation period (March 15 through April 30) shall be held beginning Thursday, May 22, 1980 and continue through Wednesday, June 25, 1980. A new special deposit amount based on the May report will then be required beginning Thursday, June 26, and will continue through Wednesday, July 23. The amount of the special deposit may not vary during each maintenance period.

The special deposit shall be maintained in collected funds in the form of U.S. dollars.

Members of the Federal Home Loan Banks and all other savings and loan associations shall maintain the special deposit with the Federal Home Loan Banks. All credit unions, whether or not members of the National Credit Union Administration's Central Liquidity Facility, shall maintain the special deposit with the Central Liquidity Facility. Deposits maintained with the Federal Home Loan Banks and the Central Liquidity Facility shall be passed through by those entities to the Federal Reserve Banks. All other covered creditors, including commercial banks, mutual savings banks, U.S. branches and agencies of foreign banks, retailers, other credit card issuers, and finance companies, shall maintain the special deposit with the Federal Reserve Bank in whose District the reporting office is located.

Where and When to Report

The first monthly report (covering the period beginning March 15 and ending April 30) shall be filed by May 12. Thereafter, each montnly report shall be filed by no later than the second Monday following the reporting month.

Members of the Federal Home Loan Banks and all other savings and loan associations should file their reports with the Federal Home Loan Bank where the deposit will be maintained.

All credit unions should file their reports with the Central Liquidity Facility of the National Credit Union Administration.

All other creditors should file their reports with the Federal Reserve Bank in whose District the reporting office is located.

How to Report

The special deposit requirement (Item 4) should be reported in dollars. All other amounts should be reported to the nearest thousand dollars.

In computing the average amount of covered consumer credit outstanding during the reporting month, use balances as of the close of business each day on which offices were open.

Amounts of covered consumer credit outstanding denominated in foreign currencies should be valued in U.S. dollars at the prevailing exchange rate at the time the transaction originally is entered into.

General Definitions

Base: The larger of $2 million or the amount of covered credit outstanding as of the close of business on the base date.

Base date: For a creditor that has daily credit data available, March 14, 1980, or the last day immediately before March 14, 1980 for which such data are available; for a creditor that does not have daily credit data available, the period immediately before March 14, 1980 for which credit data are available.

Board: The Board of Governors of the Federal Reserve System.

Closed-end credit: All consumer credit except open-end credit.

Consumer credit: Credit extended in the U.S. primarily for personal, family, or household purposes. Credit extended for business or agricultural purposes is excluded.

Covered credit: Consumer credit that is (1) open-end credit and (2) closed-end credit which is unsecured or in which the proceeds of the credit are not being used to purchase the collateral. Covered credit that is sold or otherwise transferred after March 14, 1980 to any office located outside the U.S. of the same or another entity shall remain the covered credit of the transferor until such credit is repaid. Covered credit that is sold or otherwise transferred on a recourse basis to any U.S. office of the same or another entity shall remain the covered credit of the transferor; covered credit that is transferred on a nonrecourse basis to any U.S. office of the same or another entity shall be treated as covered credit of the transferee.

Covered credit does not include insurance company policy loans; credit extended by federal, state, or local governments, or by providers of utility, health, or educational services; state or federal government guaranteed loans; or loans secured by savings deposits 1/ held at the lending institution.

Covered creditor: Any creditor which extends covered credit. For purposes of determining the amount of a creditor's outstanding covered credit, the covered credit of all U.S. offices of (1) the same company, (2) U.S. subsidiaries of the same parent company, and (3) non-U.S. subsidiaries of the same parent company shall be combined. A subsidiary is a company that is more than 50 percent owned, directly or indirectly, by another company.

Credit: The right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment.

1/ As defined in § 217.1(e) of Regulation Q.

Credit transaction: See "Extension of credit."

Creditor: Any person who extends, or arranges for the extension of, credit, whether in connection with a loan, a sale of property or services, or otherwise.

Extension of credit (or "credit transaction"): Loans, credit sales, or other supplying of funds.

Loan: Any type of credit, including credit extended in connection with a credit sale.

Open-end credit: Consumer credit extended on an account pursuant to a plan under which (1) the creditor may permit the customer to make purchases or obtain loans, from time to time, directly from the creditor or indirectly by use of a credit card, check, or other device, as the plan may provide; (2) the customer has the privilege of paying the balance in full or in instalments; and (3) a finance charge may be computed by the creditor from time to time on an outstanding unpaid balance.

Subsidiary: Any company in which more than 50 percent of the outstanding voting stock is owned directly or indirectly by another.

U.S.: The 50 states of the United States and the District of Columbia.

Non-U.S.: Any geographic area located outside the 50 states of the United States and the District of Columbia. Thus, for purposes of this report, non-U.S. includes Puerto Rico and U.S. territories and possessions.

Examples

As noted above under "General Definitions," covered credit consists of (1) all open-end consumer credit, whether secured or unsecured, and (2) closed-end consumer credit that is either unsecured or secured by collateral that is not being purchased with the proceeds of the credit.

Examples of open-end credit that is covered are:

- Credit card plans, such as cards issued by financial institutions, retailers, and oil companies.
- Overdraft and special check-type plans offered by financial institutions.
- Other revolving credit plans.

Examples of closed-end consumer credit that is covered are:

- Unsecured personal loans.
- Loans for which the collateral provided is already owned by the borrower.

- Open account and 30-day credit without regard to whether a finance charge is imposed, such as travel and entertainment card plans and retail merchant credit.
- Credit secured by financial assets, other than savings deposits, when the collateral is not purchased with the loan proceeds.

Credit extended through the use of credit cards will be presumed to be consumer--that is, non-business--credit unless the creditor establishes otherwise.

A creditor will also be required to treat as covered consumer credit any such credit that is sold or otherwise transferred to any non-U.S. office of the same or another entity and any such credit that is sold or otherwise transferred with recourse to another entity, wherever located.

Examples of consumer credit that is not covered are:

- Secured credit where the collateral is purchased with the proceeds of the loan, such as automobile, mobile home, and other chattel-secured loans (see Uniform Commercial Code § 9-107, including Official Comments 1 and 2).
- Credit secured by financial assets when the collateral is purchased with the proceeds.
- Credit secured by savings deposits held at the lending institution.
- Mortgage loans where the proceeds are used to purchase the collateral or for home improvements or "bridge" loans.
- Insurance company policy loans.
- Credit extended by providers of utility, health, and educational services.
- Credit extended under state or federal government guaranteed consumer loan programs, such as student loans.

Instructions

Include all covered consumer credit that is on the creditor's books that is not actually written off, even if during the reporting period the credit is past due and collection is doubtful. Also, report the aggregate book value of covered credit net of unearned income and before deduction of allowance for loan losses. Depositary institutions should report covered credit outstanding net of deposits accumulated for the payment of personal loans (hypothecated deposits).

Each creditor should include the amount of its share of participation loans, including participations in pools of loans, if such loans meet the definition of covered credit. Participation loans are loans made in cooperation with other financial institutions. The creditor should report only the dollar amount outstanding of its share of the participation loans even if it is the "lead" institution in the participation arrangement.

Participations in pools of loans are described as follows: (1) A "pass-through" participation, when issued by a bank or other private institutions, represents a pro-rata share in the pooled loans. In this case, the terms of the participation (e.g., maturity, interest rate, etc.) are identical to the terms of the underlying loans. Consequently, the issuing institution incurs no obligation other than to pass on proportional shares of whatever payments of principal and interest are collected from the obligors of the underlying assets in the pool. The creditor purchasing such a participation should report the underlying loans as covered consumer credit. (2) In other types of participations (i.e., those other than "pass-through" participations), the instrument of participation bears terms (e.g., maturity, interest rate, etc.) that differ from the terms of the loans comprising the pool. Consequently, the institution issuing the participation does incur an obligation on the instrument of participation itself. A creditor issuing these participations should report the underlying loans as covered consumer credit.

For Internal Use Only

FR 2063a
Approved by Federal Reserve Board March 1980

SPECIAL CREDIT RESTRAINT PROGRAM
U.S. Commercial Banks

Report for the Month of ____________

This report is required by law (12 U.S.C. §§1901-1909, as implemented by Executive Order 12201).

The Federal Reserve System regards the individual respondent information provided by each respondent as confidential. If it should be determined subsequently that any information collected on this form must be released, the respondents will be notified.

PLEASE READ INSTRUCTIONS PRIOR TO COMPLETION OF THIS REPORT

A. GENERAL QUESTIONS

1. Has your bank transmitted to the appropriate loan officers at each of its U.S. offices the content of the Board's statement on the voluntary credit restraint program?

   Yes ☐ (1)   No ☐ (2)

2. Has your bank issued specific guidelines to these loan officers to implement the program outlined in the Board's statement?

   Yes ☐ (1)   No ☐ (2)

   a. If yes, please attach a copy of these guidelines.[1]
   b. If no, please describe how you plan to implement the program:[1]

   ____

   ____

   ____

3. Taking account of seasonal patterns, how would you evaluate the current strength of total private credit demands at your bank from U.S. addresses, as compared with the situation generally prevailing during February 1980?

   Significantly greater ☐ (1)   Essentially unchanged ☐ (2)   Significantly less ☐ (3)

B. QUESTIONS RELATING TO SPECIFIC LOAN POLICIES

1. With respect to commercial and industrial loans to U.S. addresses to meet basic credit demands for normal operations:
   a. Was the number of applications or requests for such loans or loan commitments during the current month, as compared with the usual experience for the same month in recent years:

      Significantly larger ☐ (1)   Essentially unchanged ☐ (2)   Significantly less ☐ (3)

   b. In processing applications for such loans or loan commitments, was the proportion approved in the current month:

      Significantly larger than usual ☐ (1)   Essentially unchanged ☐ (2)   Significantly smaller than usual ☐ (3)

2. With respect to commercial and industrial loans to U.S. addresses to meet basic and emerging credit needs for smaller businesses:
   a. Has your bank developed a special program to assist the financing needs of smaller businesses?

      1) Yes ☐ (1)   No ☐ (2)

      2) If yes, please attach a description of the program.[1]

      3) If no, please attach an explanation as to why your bank decided not to develop such a program.[1]

---

[1] If you have supplied this material to the Federal Reserve after March 14, 1980, you need not do so again unless revisions or additions are necessary.

For Internal Use Only

b. Was the number of applications or requests for such loans or loan commitments during the current month, as compared with the usual experience for the same month in recent years:

Significantly larger ☐ (1) Essentially unchanged ☐ (2) Significantly less ☐ (3)

c. In processing applications for such loans or loan commitments, was the proportion approved in the current month:

Significantly larger than usual ☐ (1) Essentially unchanged ☐ (2) Significantly smaller than usual ☐ (3)

3. With respect to commercial and industrial loans to U.S. addresses for purely financial activities—such as purchase of a company's own shares or financing of mergers or corporate takeovers:

a. Were there any requests during the current month for such loans or loan commitments?

Yes ☐ (1) No ☐ (2)

b. Were there any approvals of loans of this type in the current month?

Yes ☐ (1) No ☐ (2)

c. Were there any takedowns for such loans under commitments made before March 1980?

Yes ☐ (1) No ☐ (2)

d. If the answer to b) or c) was "yes", please attach a brief statement of the nature of the loan.

4. With respect to loans to business customers in the United States, for speculative purposes—such as purchasing securities or commodities other than in the ordinary course of business, excessive voluntary inventory accumulation, or investing in land without well-defined plans for its useful development:

a. Were there any requests during the current month for such loans or loan commitments?

Yes ☐ (1) No ☐ (2)

b. Were there any approvals of loans of this type in the current month?

Yes ☐ (1) No ☐ (2)

c. Were there any takedowns of such loans under commitments made before March 1980?

Yes ☐ (1) No ☐ (2)

d. If the answer to b) or c) was "yes", please attach a brief statement of the nature of the loan.

5. With respect to commercial and industrial loans to non-U.S. affiliates of U.S. firms:

a. Was the number of applications or requests for such loans or loan commitments during the current month, as compared with the usual experience for the same month in recent years:

Significantly larger ☐ (1) Essentially unchanged ☐ (2) Significantly less ☐ (3)

b. In processing applications for such loans or loan commitments, was the proportion approved in the current month:

Significantly larger ☐ (1) Essentially unchanged ☐ (2) Significantly smaller than usual ☐ (3)

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FR 2083a
Page 3

C. STATISTICAL INFORMATION

	Amounts outstanding in thousands of dollars as of last Wednesday of					
	Current Month			Year-ago Month		
	Bils.	Mils.	Thous.	Bils.	Mils.	Thous.
1. The data reported below are for your bank's U.S. consolidated banking operations.						
a. Total loans and investments						
b. Total loans, gross (sum of items c, d, e, and f below)						
c. Total commercial and industrial loans (Note that Items 1 and 2 below do not add to the total reported in this line.)						
1) To U.S. addressees						
2) Loans to smaller businesses included in Item C1 c(1)						
d. Real estate loans secured primarily by residential properties						
e. Agricultural loans						
f. All other loans						
g. Lease financing receivables						
MEMO						
h. U.S. customers' liability on acceptances executed and outstanding						
i. Loan commitments to U.S. addressees						
2. The data reported below are for total commercial and industrial loans to U.S. addressees by your bank's non-U.S. offices.						
a. Loans by your foreign offices (excluding Edge subsidiaries)						
3. The data reported below are for your bank's consolidated worldwide banking operations.						
a. Total liquid assets						
b. Total discretionary liabilities						
c. Total assets						
d. Total equity capital						

D. The space below is for any explanation or comment you wish to make regarding the information reported. Please indicate for each comment the number of the item to which it applies.

I certify that the information shown on this report is correct.

Authorized Signature

Name—Please Print

Title

Area Code and Telephone Number

Name and Address of Reporting Institution

Name of Senior Officer in charge of the Special Credit Restraint Program

Title

Area Code and Telephone Number

Please return one copy of this report by April 10 to the Federal Reserve Bank in whose District the respondent is located.

For Internal Use Only

Supplement

FR 2082a(S)
Approved by Federal Reserve Board March 1980

SPECIAL CREDIT RESTRAINT PROGRAM
U.S. Commercial Banks

C. STATISTICAL INFORMATION

	Amounts outstanding in thousands of dollars as of last Wednesday of					
	February '80			February '79		
	Bils.	Mils.	Thous.	Bils.	Mils.	Thous.
1. The data reported below are for your bank's U.S. consolidated banking operations.	▨	▨	▨	▨	▨	▨
a. Total loans and investments						
b. Total loans, gross (sum of Items c, d, e, and f below)						
c. Total commercial and industrial loans (Note that Items 1 and 2 below do not add to the total reported in this line.)						
1) To U.S. addresses						
2) Loans to smaller businesses included in Item C1 c(1)						
d. Real estate loans secured primarily by residential properties						
e. Agricultural loans						
f. All other loans						
g. Lease financing receivables						
MEMO	▨	▨	▨	▨	▨	▨
h. U.S. customers' liability on acceptances executed and outstanding						
i. Loan commitments to U.S. addresses[1]						
2. The data reported below are for total commercial and industrial loans to U.S. addresses by your bank's non-U.S. offices.	▨	▨	▨	▨	▨	▨
a. Loans by your foreign offices (excluding Edge subsidiaries)						
3. The data reported below are for your bank's consolidated worldwide banking operations.	▨	▨	▨	▨	▨	▨
a. Total liquid assets						
b. Total discretionary liabilities						
c. Total assets						
d. Total equity capital						

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[1] Amounts outstanding (thousands of dollars) as of:
December 31, 1979 ____________
March 14, 1980 ____________

INSTRUCTIONS

Who Must Report

This report is required from all U.S. commercial banks with U.S. consolidated total assets of $1 billion or more.

Purpose of the Report

To assist in monitoring developments in credit markets and cooperation of individual banks with the voluntary Special Credit Restraint Program announced by the Board of Governors of the Federal Reserve System on March 14, 1980.

Where and When to Report

One copy of the completed report shall be filed by no later than the 10th business day after the last Wednesday of the month with the Federal Reserve Bank in whose district the respondent is located.

How to Report

All reports should be made out by typewriter or in ink.

For each question in Sections A and B, please place a check mark ✓ or an "X" in the appropriate box.

All amounts should be reported to the nearest thousand dollars as of the close of business on the last Wednesday of the month. Amounts denominated in foreign currencies initially should be valued in U.S. dollars at the prevailing exchange rate at the time the transaction originally is entered into, and should be revalued periodically on a consistent basis.

In the event that actual data are not available, please provide estimates.

Coverage and Consolidation

The coverage and consolidation basis for this report are the same as that for the quarterly Report of Condition (Call Report): for banks with domestic offices only, the Consolidated Report of Condition for a Bank and Its Domestic Subsidiaries; for banks with foreign offices, the Consolidated Report of Condition for a Bank and Its Domestic and Foreign Subsidiaries.

General Definitions

U.S. offices of the reporting bank. This definition corresponds to that for "domestic offices" on the quarterly Report of Condition (Call Report) and covers: (1) the bank's head office; (2) all branches located in the 50 States of the United States and the District of Columbia; and (3) all subsidiaries (except Edge Act and Agreement Corporations) located in the 50 states of the United States, the District of Columbia, Puerto Rico, and U.S. territories and possessions that are consolidated in the Call Report.

Non-U.S. offices of the reporting bank. Except as noted below, this definition corresponds to that for "foreign offices" on the Call Report and covers: (1) all branches located outside the 50 states of the United States, including branches located in Puerto Rico and U.S. territories and possessions; and (2) all subsidiaries that are located outside the 50 states of the United states the District of Columbia, Puerto Rico, and U.S. territories and possessions that are consolidated in the Call Report. Edge Act and Agreement subsidiaries should be excluded.

Worldwide banking operations of the reporting bank. All U.S. and non-U.S. offices, as defined above, and all Edge Act and Agreement subsidiaries.

Addressee. Whether a customer is "U.S." or "non-U.S." shall be determined by the customer's principal address. A U.S. address is one in the 50 States of the United States, the District of Columbia, Puerto Rico, and U.S. territories and possessions. A non-U.S. address is one located in any other geographic area. (NOTE: For additional information on the determination of customer address, please refer to the Call Report instructions).

Loan commitments. Official promises to lend that are expressly conveyed, orally or in writing, to the bank's customers. Such commitments are usually in the form of a formally executed agreement or a letter signed by one of the bank's officers. Oral commitments made by bank officers to customers are usually accompanied by some documentation for the bank's own records, such as notation in the customer's credit file.

Smaller business. As a general guideline, a "smaller business" might be one whose activities are local, or at most regional, in scope; whose loan takedowns normally do not exceed $500 thousand; and whose total loans outstanding are less than $1-1/2 million. In the event that you cannot classify borrowers according to this definition, use your best judgment as to which of your business customers come closest to it.

Item Definitions

In general, the definitions of data items on this report correspond to the definitions of corresponding items on the Call Report. Where the definition of an item on this report corresponds to one or more items on the Call Report, the corresponding Call Report items are shown in the table. For definitions and instructions for these items, please refer to the referenced items in the instructions pamphlet for the Call Report.

For terms or items that cannot be referenced to the Call Report, or where additional instructions are needed, supplementary instructions are provided below.

Section A

Private credit demands from U.S. addressees. **Include** all applications or requests for loans or loan commitments from individuals and businesses. Exclude the U.S. Treasury, federal agencies, and state and local governments. "U.S. addressees" are as defined above under "General Definitions."

Items B3d and B4d. The statement required in Items B3d and B4d should list for each loan: the industry or major activity of the borrower; the purpose of the loan; the amount and maturity of the loan; the date of approval of the commitment and takedown; and the role of your bank (lead or syndicate member).

Section C, Items 1a through 1i.

All data items should cover the reporting bank's U.S. offices, as defined above under "General Definitions." For banks with U.S. offices only, the coverage and consolidation basis are the same as that for the Consolidated Report of Condition for a Bank and Its Domestic Subsidiaries. For banks with non-U.S. offices, as defined above under "General Definitions," the coverage and consolidation basis are the same as that for the "Consolidated Domestic Office Report of Assets and Liabilities" of the Consolidated Report of Condition for a Bank and Its Domestic and Foreign Subsidiaries.

Section C, Item 2.

This data item should cover the reporting bank's non-U.S. offices, as defined above under "General Definitions."

For banks with U.S. offices only, this section is not applicable. For banks with non-U.S. offices, the coverage and consolidation basis are the same as that for the "foreign office" portion of the Consolidation Report of Condition for a Bank and Its Domestic and Foreign Subsidiaries, EXCLUDING Edge Act and Agreement subsidiaries.

Section C, Item 3.

All data items should cover the reporting bank's worldwide banking operations, as defined above under "General Definitions."

For banks with U.S. offices only, the coverage and consolidation basis are the same as that for the Consolidated Report of Condition for a Bank and Its Domestic Subsidiaries. For banks with non-U.S. offices, the coverage and consolidation basis are the same as that for the Consolidated Report of Condition for a Bank and Its Domestic and Foreign Subsidiaries.

Item C3a, Total liquid assets. This item consists of the following components. Call Report references for each component are provided in the table.

(1) Deposits with remaining maturities of one year or less due from other U.S. and non-U.S. banks.

(2) Federal funds sold and securities purchased under agreements to resell in domestic offices of the reporting bank and of its Edge Act and Agreement subsidiaries.

(3) U.S. Treasury, federal agency, state, and local government securities with remaining maturities of one year or less. This includes both investment and trading account securities.

(4) Loans to brokers and dealers.

(5) Loans to commercial banks in the United States and to banks in foreign countries.

(6) Holdings of bankers acceptances and commercial paper.

Item C3b, Total discretionary liabilities. This item consists of the following components. Call Report references for each component are provided in the table below.

(1) Time deposits in denominations of $100,000 or more with remaining maturities of one year or less in U.S. offices.

(2) Interest-bearing deposit liabilities of non-U.S. offices in remaining maturities of one year or less.

(3) Federal funds purchased and securities sold under agreements to repurchase in U.S. offices of the reporting bank and of its Edge Act and Agreement subsidiaries.

(4) Interest-bearing demand notes (note balances) issued to the U.S. Treasury and other liabilities for borrowed money.

FR 2083a Items	Report of Condition	
	For Banks that Submit the Standard Version of the *Consolidated Report of Condition For a Bank and Its Domestic Subsidiaries*	For Banks that Submit the *Consolidated Report of Condition For a Bank and Its Domestic and Foreign Subsidiaries*
SECTION C1: U.S. Offices of the Reporting Bank		
C1a. Total loans, gross, and investments.	Asset items 2, 3, 4, 5, 6, and 7, plus Schedule A, item 8.	Domestic office substatement items 2, 3, 4, 5, 6, and 7, plus Schedule A, Column B, item 8.
C1b. Total loans, gross.	Schedule A, item 8.	Schedule A, Column B, item 8.
C1c. Total commercial and industrial loans.	Schedule A, item 5.	Schedule A, Column B, items 5a and 5b.
1) To U.S. addressees.	No Report of Condition equivalent. Report in this item the amount outstanding of all C&I loans to U.S. addressees included in Schedule A, item 5.	Schedule A, Column B, item 5a.
2) To smaller businesses.	No Report of Condition equivalent. Report in this item the amount outstanding of all C&I loans to smaller businesses (as defined in "General Definitions") included in item C1c(1) above of this report.	
C1d. Real estate loans secured primarily by residential properties.	Schedule A, items 1c and 1d.	Schedule A, Column B, items 1c and 1d.
C1e. Agricultural loans.	Schedule A, item 4.	Schedule A, Column B, item 4.
C1f. All other loans.	Schedule A, items 1a, 1b, 1e, 2, 3, 6, and 7.	Schedule A, Column B, items 1a, 1b, 1e, 2, 3, 6, and 7.
C1g. Lease financing receivables.	Asset item 10.	Domestic office substatement item 10.
C1h. U.S. customers' liability on acceptances executed and outstanding.	Amount included in Asset item 14 for U.S. addressees.	Amount included in domestic office substatement Asset item 14 for U.S. addressees.
C1i. Loan commitments to U.S. addressees.	No Report of Condition equivalent. See "General Definitions" above.	
SECTION C2: Non-U.S. Offices of the Reporting Bank		
C2a. Total commercial and industrial loans to U.S. addressees.	Not applicable.	Schedule A, Column C, item 5a, excluding loans made by Edge Act and Agreement subsidiaries.
SECTION C3: Consolidated Worldwide Banking Operations		
C3a. Total liquid assets:		
1) Deposits with remaining maturity of one year or less due from other U.S. and non-U.S. banks.	Amount of deposits with remaining maturity of one year or less included in Schedule C, items 3, 4, and 5.	Amount of deposits with remaining maturity of one year or less included in Schedule C, Column A, items 3, 4, and 5.
2) Federal funds sold and securities purchased under agreements to resell in domestic offices of the bank and of its Edge Act and Agreement subsidiaries.	Asset item 8.	Asset item 8.
3) U.S. Treasury, Federal agency, state, and local government securities with remaining maturities of one year or less.	Amount of securities with maturities of one year or less included in Asset items 2, 3, and 4, plus amount of such securities held in trading account and included in Asset item 6.	Amount of securities with maturities of one year or less included in Asset items 2, 3, and 4, plus amount of such securities held in trading account and included in Asset item 6.
4) Loans to brokers and dealers.	Schedule A, item 3a.	Schedule A, Column A, item 3a.
5) Loans to commercial banks in the U.S. and to banks in foreign countries.	Schedule A, items 2b and 2c.	Schedule A, Column A, items 2b and 2c.
6) Holdings of bankers acceptances and commercial paper.	Schedule A, Memo item 1, plus amount of bankers acceptances included in Schedule A.	Amount of bankers acceptances and commercial paper included in Schedule A, Column A.

SECTION C3: Consolidated Worldwide Banking Operations (cont.)		
C3a. Total discretionary liabilities.		
1) Time deposits in denominations of $100,000 or more with remaining maturity of one year or less in U.S. offices.	**Amount of time deposits with remaining maturities of one year or less included in Memo items 1b and 1c.**	**Amount of time deposits with remaining maturities of one year or less included in Memo items 1b and 1c.**
2) Interest-bearing deposit liabilities of non-U.S. offices and Edge Act and Agreement subsidiaries in remaining maturities of one year or less.	**Not applicable.**	**Large Banks Supplement B, Column B, items 1, 2, and 3.**
3) Federal funds purchased and securities sold under agreements to repurchase in domestic offices of the bank and of its Edge and Agreement subsidiaries.	**Liability item 25.**	**Liability item 25.**
4) Interest-bearing demand notes (note balances) issued to the U.S. Treasury and other liabilities for borrowed money.	**Liability items 26a and 26b.**	**Liability items 26a and 26b.**
C3b. Total assets.	**Asset item 18.**	**Asset item 18.**
C3c. Total equity capital.	**Equity Capital item 37.**	**Equity Capital item 37.**

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FR 2082b
Approved by Federal Reserve Board March 1980

SPECIAL CREDIT RESTRAINT PROGRAM
U.S. Branches and Agencies of Foreign Banks

Report for the Month of ____________

This report is required by law (12 U.S.C. §§1901-1909, as implemented by Executive Order 12201).

The Federal Reserve System regards the individual respondent information provided by each respondent as confidential. If it should be determined subsequently that any information collected on this form must be released, respondents will be notified.

PLEASE READ INSTRUCTIONS PRIOR TO COMPLETION OF THIS REPORT

A. GENERAL QUESTIONS

1. Has your bank transmitted to its foreign parent bank the content of the Board's statement on the voluntary credit restraint program?

   Yes ☐(1) No ☐(2)

2. Has your bank transmitted the content of the Board's statement to the appropriate loan officers at each of its U.S. offices?

   Yes ☐(1) No ☐(2)

3. Has your bank issued specific guidelines to these loan officers to implement the program outlined in the Board's statement?

   Yes ☐(1) No ☐(2)

   a. If yes, please attach a copy of these guidelines.[1]
   b. If no, please describe how your bank plans to implement the program:[1]

   ____

   ____

   ____

4. Taking account of seasonal patterns, how would you evaluate the current strength of total private credit demands at your bank from U.S. addressees, as compared with the situation generally prevailing during February 1980?

   Significantly greater ☐(1) Essentially unchanged ☐(2) Significantly less ☐(3)

B. QUESTIONS RELATING TO SPECIFIC LOAN POLICIES

1. With respect to commercial and industrial loans to U.S. addressees to meet basic credit demands for normal operations:
   a. Was the number of applications or requests for such loans or loan commitments during the current month, as compared with the usual experience for the same month in recent years:

      Significantly larger ☐(1) Essentially unchanged ☐(2) Significantly less ☐(3)

   b. In processing applications for such loans or loan commitments, was the proportion approved in the current month:

      Significantly larger than usual ☐(1) Essentially unchanged ☐(2) Significantly smaller than usual ☐(3)

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[1] If you have supplied this material to the Federal Reserve after March 14, 1980, you need not do so again unless revisions or additions are necessary.

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FR 2083b
Page 2

2. With respect to commercial and industrial loans to U.S. addressees to meet basic and emerging credit needs for smaller businesses:

   a. Has your bank developed a special program to assist the financing needs of smaller businesses?

      1) Yes ☐ (1)   No ☐ (2)

      2) If yes, please attach a description of the program.[1]
      3) If no, please attach an explanation as to why your bank decided not to develop such a program.[1]

   b. Was the number of applications or requests for such loans or loan commitments during the current month, as compared with the usual experience for the same month in recent years:

      Significantly larger ☐ (1)   Essentially unchanged ☐ (2)   Significantly less ☐ (3)

   c. In processing applications for such loans or loan commitments, was the proportion approved in the current month:

      Significantly larger than usual ☐ (1)   Essentially unchanged ☐ (2)   Significantly smaller than usual ☐ (3)

3. With respect to commercial and industrial loans to U.S. addressees for purely financial activities—such as purchase of a company's own shares or financing of mergers or corporate takeovers in the United States:

   a. Were there any requests during the current month for such loans or loan commitments?

      Yes ☐ (1)   No ☐ (2)

   b. Were there any approvals of loans of this type in the current month?

      Yes ☐ (1)   No ☐ (2)

   c. Were there any takedowns for such loans under commitments made before March 1980?

      Yes ☐ (1)   No ☐ (2)

   d. If the answer to b. or c. was "yes", please attach a brief statement of the nature of the loan.

4. With respect to loans to business customers in the United States, for speculative purposes—such as purchasing securities or commodities other than in the ordinary course of business, excessive voluntary inventory accumulation, or investing in land without well-defined plans for its useful development:

   a. Were there any requests during the current month for such loans or loan commitments?

      Yes ☐ (1)   No ☐ (2)

   b. Were there any approvals of loans of this type in the current month?

      Yes ☐ (1)   No ☐ (2)

   c. Were there any takedowns of such loans under commitments made before March 1980?

      Yes ☐ (1)   No ☐ (2)

   d. If the answer to b. or c. was "yes", please attach a brief statement of the nature of the loan.

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[1] If you have supplied this material to the Federal Reserve after March 14, 1980, you need not do so again unless revisions or additions are necessary.

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FR2083b
Page 4

D. The space below is for any explanation or comment you wish to make regarding the information reported. Please indicate for each comment the number of the item to which it applies.

I certify that the information shown on this report is correct.

Authorized Signature

Name - Please Print

Title

Area Code and Telephone No.

Please list the other individual offices covered in this report

Please return one copy of this report by April 10 to the Federal Reserve Bank in whose District the respondent is located.

Name and Address of Reporting Institution

Name of Senior Officer in Charge of the Special Credit Restraint Program

Title

Area Code and Telephone Number

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Page 3

5. With respect to commercial and industrial loans to U.S. addressees, did your bank during the current month:
   - a. Rebook any maturing loans from your U.S. balance sheet at offshore bank or nonbank affiliates?

     Yes ☐ (1) No ☐ (2)

   - b. Sell loans to non-U.S. offices of your foreign parent bank?

     Yes ☐ (1) No ☐ (2)

   - c. Make new loans abroad that would normally be booked in the United States?

     Yes ☐ (1) No ☐ (2)

6. The following information is for foreign-booked commercial and industrial loans to U.S. corporations, their non-U.S. affiliates, or the U.S. affiliates of non-U.S. corporations.
   - a. With respect to loans to U.S. addressees whether U.S.- or non-U.S.-owned:
     1) Was the number of applications or requests for such loans or loan commitments during the current month, as compared with the usual experience for the same month in recent years:

        Significantly larger ☐ (1) Essentially unchanged ☐ (2) Significantly less ☐ (3)

     2) In processing applications for such loans or loan commitments, was the proportion approved in the current month:

        Significantly larger than usual ☐ (1) Essentially unchanged ☐ (2) Significantly smaller than usual ☐ (3)

   - b. With respect to loans to non-U.S. affiliates of U.S. firms:
     1) Was the number of applications or requests for such loans or loan commitments during the current month, as compared with the usual experience for the same month in recent years:

        Significantly larger ☐ (1) Essentially unchanged ☐ (2) Significantly less ☐ (3)

     2) In processing applications for such loans or loan commitments, was the proportion approved in the current month:

        Significantly larger than usual ☐ (1) Essentially unchanged ☐ (2) Significantly smaller than usual ☐ (3)

C. THE DATA REPORTED BELOW ARE FOR YOUR BANK'S U.S. BANKING OPERATIONS

	Amounts outstanding in thousands of dollars as of last Wednesday of					
	Current Month			Year ago month		
	Bil.	Mil.	Thous.	Bil.	Mil.	Thous.
1. Total loans and investments						
2. Total loans (sum of items 3, 4, 5, and 6 below)						
3. Total commercial and industrial loans (Note that items a. and b. below do not add to the total reported in this line.)						
a. To U.S. addressees						
b. Loans to smaller businesses included in Item C3a						
4. Real estate loans secured primarily by residential properties						
5. Agricultural loans						
6. All other loans						
7. Lease financing receivables						
MEMO:	▨	▨	▨	▨	▨	▨
8. U.S. customers' liability on acceptances executed and outstanding						
9. Loan commitments to U.S. addressees						

For Internal Use Only

Supplement

FR [illegible]
Approved by Federal Reserve Board March 1980

SPECIAL CREDIT RESTRAINT PROGRAM
U.S. Branches and Agencies of Foreign Banks

C. THE DATA REPORTED BELOW ARE FOR YOUR BANK'S U.S. BANKING OPERATIONS

	Amount outstanding in thousands of dollars as of last Wednesday of					
	February '80			February '79		
	Bils.	Mils.	Thous.	Bils.	Mils.	Thous.
1. Total loans and investments						
2. Total loans (sum of items 3, 4, 5, and 6 below)						
3. Total commercial and industrial loans (Note that items a. and b. below do not add to the total reported on this line)						
a. To U.S. addressees						
b. Loans to smaller businesses included in item C3a						
4. Real estate loans secured primarily by residential properties						
5. Agricultural loans						
6. All other loans						
7. Lease financing receivables						
MEMO:	▨	▨	▨	▨	▨	▨
8. U.S. customers' liability on acceptances executed and outstanding						
9. Loan commitments to U.S. addressees[1]						

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[1] Amounts outstanding (thousands of dollars) as of:
December 31, 1979 ____________
March 14, 1980 ____________

FR 2062b

INSTRUCTIONS

Who Must Report

This report is required from each family of U.S. branches and agencies of a bank organized under foreign (non-U.S.) law that has worldwide banking assets of more than $1 billion (U.S. dollars). (The terms "U.S. and "non-U.S." are defined below.) A family is defined as all U.S. branches and agencies of your foreign parent bank and of its majority-owned foreign banking subsidiaries. This report is to be filed by the office that is reporting for purposes of the marginal reserve requirement program. For any question that refers to "your bank," please respond for all U.S. branches and agencies of your foreign parent bank and of its majority-owned foreign banking subsidiaries. Where appropriate, please consult with your foreign banking affiliates in completing this report.

In preparing this report, all intra-family U.S. office asset and liability amounts should be ignored and should not be included in any data item.

Purpose of the Report

To assist in monitoring developments in credit markets and cooperation of individual foreign bank families with the voluntary Special Credit Restraint Program announced by the Board of Governors of the Federal Reserve Systems on March 14, 1980.

Where and When to Report

One copy of the completed report shall be filed by no later than the 10th business day after the last Wednesday of the month with the Federal Reserve Bank in whose district the reporting office is located.

How to Report

All reports should be made out by typewriter or in ink.

For each question in Sections A and B, please place a check mark (✓) or an "X" in the appropriate box.

All amounts should be reported to the nearest thousand dollars (U.S.) as of the close of business on the last Wednesday of the month. Amounts denominated in foreign currencies initially should be valued in U.S. dollars at the prevailing exchange rate at the time the transaction originally is entered into, and should be revalued periodically on a consistent basis.

In the event that actual data are not available, please provide estimates.

GENERAL DEFINITIONS

U.S.: The 50 states of the United States and the District of Columbia.

Non-U.S.: Any geographic area located outside the 50 states of the United States and the District of Columbia. Thus, for purposes of this report, non-U.S. includes Puerto Rico and U.S. territories and possessions.

Addressee: Whether a customer is "U.S." or "non-U.S." shall be determined by the customer's principal address. A U.S. address is one in the 50 states of the United States, the District of Columbia, Puerto Rico and U.S. territories and possessions. A non-U.S. address is one in any other geographic area.

Smaller business: As a general guideline, a "smaller business" might be one whose activities are local, or at most regional, in scope; whose loan takedowns normally do not exceed $500 thousand; and whose total loans outstanding are less than $1-1/2 million. In the event that you cannot classify borrowers according to this definition, use your best judgment as to which of your business customers comes closest to it.

Loan commitments: Official promises to lend that are expressely conveyed, orally or in writing, to the institution's customers. Such commitments are usually in the form of a formally executed agreement or a letter signed by one of the institution's officers. Oral commitments made by officers to customers are usually accompanied by some documentation for the institution's own records, such as notation in the customer's credit file.

ITEM DEFINITIONS

In general, the definitions of data items on this report correspond to the definitions of corresponding items on the quarterly Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks (FFIEC 002). Where such definitions correspond, the appropriate references to the quarterly report are provided in the table. For definitions and instructions for these items, please refer to the instructions pamphlet for the quarterly report. Please note, however, that the office coverage and consolidation basis for FR 2062 differ from the FFIEC 002.

For items that cannot be referenced to the quarterly report, or where additional instructions are needed, instructions are provided below.

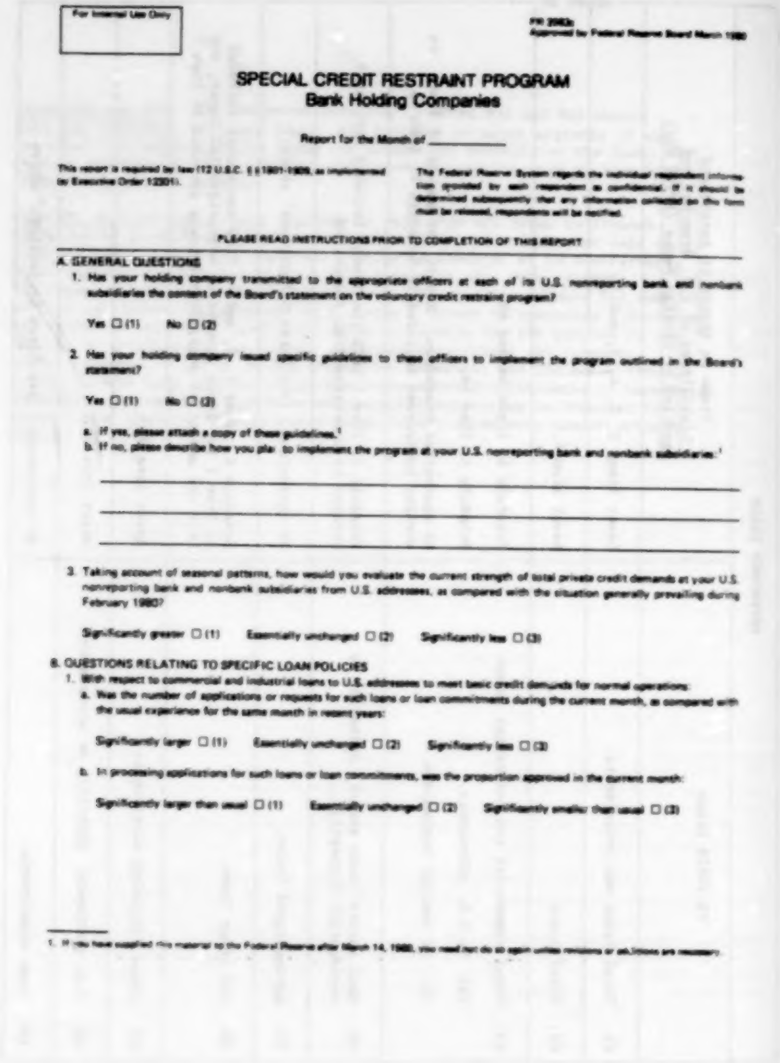
Item A4, Private credit demands from U.S. addressees. Include all applications or requests for loans or loan commitments from individuals and businesses. Exclude the U.S. Treasury, federal agencies, and state and local governments. "U.S. addressees" are defined under "General Definitions."

Items B3d and B4d: The statement required in Items B3d and B4d should list the following for each loan: the industry or major activity of the borrower: the purpose of the loan; the amount and maturity of the loan; the date of approval of the commitment and takedown; and the role of your bank (lead or syndicate member).

Item C5, Agricultural loans: Include in this item all loans to finance agricultural production, whether secured or unsecured and whether made to farm and ranch owners and operators (including tenants) or to non-farmers. Other loans to farmers should also be reported in this item, EXCEPT (1) loans secured primarily by real estate; (2) loans to farmers for commercial and industrial pruposes (e.g., when a farmer is operating a business enterprise as well as a farm); (3) loans to farmers for the purpose of purchasing or carrying stocks, bonds, and other securities; (4) loans to farmers secured by oil or mining production payments; and (5) notes insured by the Farmers Home Administration and instruments (certificates of beneficial ownership, insured note insurance contracts) representing an interest in Farmers Home Administration insured notes (these notes were issued prior to January 1, 1975).

REFERENCE TABLE

FR 2062B Items	Items on Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks (FFIEC 002)
C1. Total loans and investments.	Asset Items 2, 3, 4, 5, and 7.
C2. Total loans.	Asset Item 7.
C3. Total commercial and industrial loans.	Schedule A, Items 4a and 4b.
(a) To U.S. addressees.	Schedule A, Item 4a.
(b) To smaller businesses.	No equivalent breakdown. Report the amount of loans to smaller businesses included in Schedule A, Item 4a.
C4. Real estate loans secured primarily by residential properties.	Schedule A, Item 1 LESS the amount included for loans secured by nonresidential properties.
C5. Agricultural loans.	No equivalent. See "Item Definitions" above.
C6. All other loans.	Schedule A, Items 2, 3, and 7, PLUS the amount included in Item 1 for loans secured by nonresidential loans, and LESS the amount of agricultural loans included in Item 7.
C7. Lease financing receivables.	Asset Item 8.
C8. U.S. customers' liability on acceptances.	Asset Item 9a.
C9. Loan commitments.	No equivalent. See "Item Definitions" above.



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FR 2063b
Approved by Federal Reserve Board March 1980

SPECIAL CREDIT RESTRAINT PROGRAM
Bank Holding Companies

Report for the Month of ___________

This report is required by law (12 U.S.C. §§1901-1909, as implemented by Executive Order 12201).

The Federal Reserve System regards the individual respondent information provided by each respondent as confidential. If it should be determined subsequently that any information collected on this form must be released, respondents will be notified.

PLEASE READ INSTRUCTIONS PRIOR TO COMPLETION OF THIS REPORT

A. GENERAL QUESTIONS

1. Has your holding company transmitted to the appropriate officers at each of its U.S. nonreporting bank and nonbank subsidiaries the content of the Board's statement on the voluntary credit restraint program?

   Yes ☐ (1)   No ☐ (2)

2. Has your holding company issued specific guidelines to these officers to implement the program outlined in the Board's statement?

   Yes ☐ (1)   No ☐ (2)

   a. If yes, please attach a copy of these guidelines.[1]
   b. If no, please describe how you plan to implement the program at your U.S. nonreporting bank and nonbank subsidiaries:[1]

   ____

   ____

   ____

3. Taking account of seasonal patterns, how would you evaluate the current strength of total private credit demands at your U.S. nonreporting bank and nonbank subsidiaries from U.S. addressees, as compared with the situation generally prevailing during February 1980?

   Significantly greater ☐ (1)   Essentially unchanged ☐ (2)   Significantly less ☐ (3)

B. QUESTIONS RELATING TO SPECIFIC LOAN POLICIES

1. With respect to commercial and industrial loans to U.S. addressees to meet basic credit demands for normal operations:
   a. Was the number of applications or requests for such loans or loan commitments during the current month, as compared with the usual experience for the same month in recent years:

      Significantly larger ☐ (1)   Essentially unchanged ☐ (2)   Significantly less ☐ (3)

   b. In processing applications for such loans or loan commitments, was the proportion approved in the current month:

      Significantly larger than usual ☐ (1)   Essentially unchanged ☐ (2)   Significantly smaller than usual ☐ (3)

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[1] If you have supplied this material to the Federal Reserve after March 14, 1980, you need not do so again unless revisions or additions are necessary.

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Page [illegible]

2. With respect to commercial and industrial loans to U.S. addressees to meet basic and emerging credit needs for smaller businesses:
   a. Have your U.S. nonreporting bank and nonbank subsidiaries developed special programs to assist the financing needs of smaller businesses?

      1) Yes ☐ (1)   No ☐ (2)

      2) If yes, please attach a description of the programs.[1]
      3) If no, please attach an explanation as to why some or all of these subsidiaries decided not to develop such a program.[1]
   b. Was the number of applications or requests for such loans or loan commitments during the current month, as compared with the usual experience for the same month in recent years:

      Significantly larger ☐ (1)   Essentially unchanged ☐ (2)   Significantly less ☐ (3)

   c. In processing applications for such loans or loan commitments, was the proportion approved in the current month:

      Significantly larger than usual ☐ (1)   Essentially unchanged ☐ (2)   Significantly smaller than usual ☐ (3)

3. With respect to commercial and industrial loans to U.S. addressees for purely financial activities—such as purchase of a company's own shares or financing of mergers or corporate takeovers:
   a. Were there any requests during the current month for such loans or loan commitments?

      Yes ☐ (1)   No ☐ (2)

   b. Were there any approvals of loans of this type in the current month?

      Yes ☐ (1)   No ☐ (2)

   c. Were there any takedowns for such loans under commitments made before March 1980?

      Yes ☐ (1)   No ☐ (2)

   d. If the answer to b. or c. was "yes", please attach a brief statement of the nature of the loan.
4. With respect to loans to business customers in the United States, for speculative purposes—such as purchasing securities or commodities other than in the ordinary course of business, excessive voluntary inventory accumulation, or investing in land without well-defined plans for its useful development:
   a. Were there any requests during the current month for such loans or loan commitments?

      Yes ☐ (1)   No ☐ (2)

   b. Were there any approvals of loans of this type in the current month?

      Yes ☐ (1)   No ☐ (2)

   c. Were there any takedowns of such loans under commitments made before March 1980?

      Yes ☐ (1)   No ☐ (2)

   d. If the answer to b. or c. was "yes," please attach a brief statement of the nature of the loan.

---

[1] If you have supplied this material to the Federal Reserve after March 14, 1980, you need not do so again unless revisions or additions are necessary.

For Internal Use Only

FR [illegible]
Page 3

C. The data reported below are for estimated total commercial and industrial loans and leases to U.S. addressees, if any, by the specified types of your holding company's subsidiaries.

	Amounts outstanding in thousands of dollars as of last Wednesday of					
	Current Month			Year-ago Month		
	Bil.	Mil.	Thous.	Bil.	Mil.	Thous.
1. U.S. nonbank subsidiaries						
2. Nonreporting U.S. commercial banks (including their branches and U.S. operations subsidiaries)						
3. Nonreporting non-U.S. bank and nonbank subsidiaries (except non-U.S. offices of reporting U.S. subsidiaries)						
MEMO, for bank subsidiaries included in 2 and 3 above:	▨	▨	▨	▨	▨	▨
4. Liability of customers in the United States on acceptances executed and outstanding						
5. Loan commitments to U.S. addressees						

D. The space below is for any explanation or comment you wish to make regarding the information reported. Please indicate for each comment the number of the item to which it applies.

I certify that the information shown on this report is correct.

Authorized Signature

Name–Please Print

Title

Area Code and Telephone Number

Name and Address of Reporting Institution

Name of Senior Officer in Charge of the Special Credit Restraint Program

Title

Area Code and Telephone Number

Please return one copy of this report by April 10 to the Federal Reserve Bank in whose District the respondent is located.

For Internal Use Only

F R [illegible]
Approved by Federal Reserve Board March 1980

Supplement

SPECIAL CREDIT RESTRAINT PROGRAM
Bank Holding Companies

C. The data reported below are for estimated total commercial and industrial loans and leases to U.S. addressees, if any, by the specified types of your holding company's subsidiaries.

	Amounts outstanding in thousands of dollars as of last Wednesday of					
	February '80			February '79		
	Bils.	Mils.	Thous.	Bils.	Mils.	Thous.
1. U.S. nonbank subsidiaries						
2. Nonreporting U.S. commercial banks (including their branches and U.S. operations subsidiaries)						
3. Nonreporting non-U.S. bank and nonbank subsidiaries (except non-U.S. offices of reporting U.S. subsidiaries)						
MEMO, for bank subsidiaries included in 2 and 3 above:	▨	▨	▨	▨	▨	▨
4. Liability of customers in the United States on acceptances executed and outstanding						
5. Loan commitments to U.S. addressees[1]						

---

[1] Amounts outstanding (thousands of dollars) as of:
December 31, 1979 ____________
March 14, 1980 ____________

INSTRUCTIONS

Who Must Report

This report is required from all U.S. bank holding companies with U.S. consolidated financial assets of $1 billion or more.

Purpose of the Report

To assist in monitoring developments in credit markets and cooperation of individual bank holding companies with the voluntary Special Credit Restraint Program announced by the Board of Governors of the Federal Reserve System on March 14, 1980.

Where and When to Report

One copy of the completed report shall be filed by no later than the 10th business day after the last Wednesday of the month with the Federal Reserve Bank in whose district the respondent is located.

How to Report

All reports should be made out by typewriter or in ink.

For each question in Sections A and B, please place a check mark (✓) or an "X" in the appropriate box.

All amounts should be reported to the nearest thousand dollars as of the close of business on the last Wednesday of the month. Amounts denominated in foreign currencies initially should be valued in U.S. dollars at the prevailing exchange rate at the time the transaction originally is entered into, and should be revalued periodically on a consistent basis.

In the event that actual data are not available, please provide estimates.

Coverage and Consolidation

Unless otherwise indicated, all information in this report should pertain to the U.S. offices of the holding company and its subsidiaries. Exclude subsidiaries that are reporting separately under other parts of the Special Credit Restraint Program.

For subsidiary banks, the coverage and consolidation basis for this report are the same as that for the quarterly Report of Condition (Call Report): for banks with domestic offices only, the Consolidated Report of Condition for a Bank and Its Domestic Subsidiaries; for banks with foreign offices, the Consolidated Report of Condition for a Bank and Its Domestic and Foreign Subsidiaries.

GENERAL DEFINITIONS

U.S. subsidiaries/non-U.S. subsidiaries. The definitions of "U.S." and "non-U.S." correspond to those for "domestic" and "foreign" on the Bank Holding Company Financial Supplement (Form FR Y-9).

U.S. offices of a subsidiary bank. This definition corresponds to that for "domestic offices" on the quarterly Report of Condition (Call Report) and covers: (1) the bank's head office; (2) all branches located in the 50 states of the United States and the District of Columbia; and (3) all subsidiaries (except Edge Act and Agreement Corporations) located in the 50 states of the United States, the District of Columbia, Puerto Rico, and U.S. territories and possessions that are consolidated in the Call Report.

Non-U.S. offices of the reporting bank. Except as noted below, this definition corresponds to that for "foreign offices" on the Call Report and covers: (1) all branches located outside the 50 states of the United States, including branches located in Puerto Rico and U.S. territories and possessions; and (2) all subsidiaries that are located outside the 50 states of the United States, the District of Columbia, Puerto Rico, and U.S. territories and possessions that are consolidated in the Call Report. Edge Act and Agreement subsidiaries should be excluded.

Nonreporting subsidiary U.S. banks. U.S. commercial banks with less than $1 billion of U.S. consolidated total assets (and thus not required to report on Form FR 2062a).

Nonbank subsidiaries. Subsidiaries that make commercial and industrial loans or engage in lease financing. Exclude U.S. finance company subsidiaries that are filing separately on Form FR 2062d.

Addressee. Whether a customer is "U.S." or "non-U.S." shall be determined by the customer's principal address. A U.S. address is one in the 50 states of the United States, the District of Columbia, Puerto Rico, and U.S. territories and possessions. A non-U.S. address is one located in any other geographic area.

Private credit demands from U.S. addressees. Include all applications or requests for loans or loan commitments from individuals and businesses. Exclude the U.S. Treasury, federal agencies, and state and local governments. "U.S. addressees" are as defined above.

Commercial and industrial loans. This definition corresponds with that for Item 9a(3) of Form FR Y-9, Part A.

Lease Financing. This definition corresponds with that for Item 10 of Form FR Y-9, Part A.

Loan commitments. Official promises to lend that are expressly conveyed, orally or in writing, to customers. Such commitments are usually in the form of a formally executed agreement or a letter signed by one of the lending institution's officers. Oral commitments made by officers to customers are usually accompanied by some documentation for the institution's own records, such as notation in the customer's credit file.

Smaller business. As a general guideline, a "smaller business" might be one whose activities are local, or at most regional, in scope; whose loan takedowns normally do not exceed $500 thousand; and whose total loans outstanding are less than $1-1/2 million. In the event that you cannot classify borrowers according to this definition, use your best judgment as to which of your business customers come closest to it.

Items B3d and B4d. The statement required in Items B3d and B4d should list the following for each loan: the industry or major activity of the borrower; the purpose of the loan; the amount and maturity of the loan; and the date of approval of the commitment and takedown.

For Internal Use Only

FR 2863d
OMB No. 55-R-0071
Approved by Federal Reserve Board and OMB
March 1980

SPECIAL CREDIT RESTRAINT PROGRAM
Finance Companies

Report for the Month of ____________

This report is required by law (12 U.S.C. §§1901-1909, as implemented by Executive Order 12201).

The Federal Reserve System regards the individual respondent information provided by each respondent as confidential. If it should be determined subsequently that any information collected on this form must be released, respondents will be notified.

PLEASE READ INSTRUCTIONS PRIOR TO COMPLETION OF THIS REPORT

A. GENERAL QUESTIONS

1. Has your company transmitted to the appropriate officers at each of its U.S. offices the content of the Board's statement on the voluntary credit restraint program?

   Yes ☐ (1)   No ☐ (2)

2. Has your company issued specific guidelines to these loan officers to implement the program outlined in the Board's statement?

   Yes ☐ (1)   No ☐ (2)

   a. If yes, please attach a copy of these guidelines.[1]
   b. If no, please describe how you plan to implement the program:[1]

   ____

   ____

   ____

3. Taking account of seasonal patterns, how would you evaluate the current strength of total private credit demands at your company from U.S. addresses, as compared with the situation generally prevailing during February 1980?

   Significantly greater ☐ (1)   Essentially unchanged ☐ (2)   Significantly less ☐ (3)

B. QUESTIONS RELATING TO SPECIFIC POLICIES

1. With respect to business loans to U.S. addresses to meet basic credit demands for normal operations:
   a. Was the number of applications or requests for such credit during the current month, as compared with the usual experience for the same month in recent years:

      Significantly larger ☐ (1)   Essentially unchanged ☐ (2)   Significantly less ☐ (3)

   b. In processing applications for such credit, was the proportion approved in the current month:

      Significantly larger than usual ☐ (1)   Essentially unchanged ☐ (2)   Significantly smaller than usual ☐ (3)

2. With respect to business loans to U.S. addresses to meet basic and emerging credit needs for smaller businesses:
   a. Has your company developed a special program to assist the financing needs of smaller businesses?

      1) Yes ☐ (1)   No ☐ (2)

      2) If yes, please attach a description of the program.[1]
      3) If no, please attach an explanation as to why your company decided not to develop such a program.[1]

---

[1] If you have supplied this material to the Federal Reserve after March 14, 1980, you need not do so again unless revisions or additions are necessary.

For Internal Use Only

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b. Was the number of applications or requests for such credit or loan commitments during the current month, as compared with the usual experience for the same month in recent years:

Significantly larger ☐ (1) Essentially unchanged ☐ (2) Significantly less ☐ (3)

c. In processing applications for such credit, was the proportion approved in the current month:

Significantly larger than usual ☐ (1) Essentially unchanged ☐ (2) Significantly smaller than usual ☐ (3)

3. With respect to business loans to U.S. addressees for purely financial activities—such as purchase of a company's own shares or financing of mergers or corporate takeovers:

a. Were there any requests for such loans during the current month?

Yes ☐ (1) No ☐ (2)

b. Were there any approvals of loans of this type in the current month?

Yes ☐ (1) No ☐ (2)

c. Were there any takedowns for such loans under arrangements approved before March 1980?

Yes ☐ (1) No ☐ (2)

d. If the answer to b. or c. was "yes", please attach a brief statement of the nature of the loan.

4. With respect to loans to business customers in the United States, for speculative purposes—such as purchasing securities or commodities other than in the ordinary course of business, excessive voluntary inventory accumulation, or investing in land without well-defined plans for its useful development:

a. Were there any requests for such credit during the current month?

Yes ☐ (1) No ☐ (2)

b. Were there any approvals of loans of this type in the current month?

Yes ☐ (1) No ☐ (2)

c. Were there any takedowns of such loans under arrangements approved before March 1980?

Yes ☐ (1) No ☐ (2)

d. If the answer to b. or c. was "yes", please attach a brief statement of the nature of the loan.

For Internal Use Only

FR 2082d
Page 3

C. STATISTICAL INFORMATION

	Amounts outstanding in thousands of dollars as of last day of					
	Current Month			Year-ago Month		
	Bils.	Mils.	Thous.	Bils.	Mils.	Thous.
1. The data reported below are for your company's U.S. consolidated operations.						
a. Total accounts receivable						
b. Total business receivables (Note that items (1), (2), and (3) below do not add to the total reported in this line.)						
1) From U.S. addressees						
2) Loans to smaller businesses included in item C1b						
3) Lease financing receivables included in item C1b						
2. The data reported below are for total business loans to U.S. addressees by your company's non-U.S. offices.	▨	▨	▨	▨	▨	▨
a. Loans by your foreign offices						

D. The space below is for any explanation or comment you wish to make regarding the information reported. Please indicate for each comment the number of the item to which it applies.

I certify that the information shown on this report is correct.

Authorized Signature

Name–Please Print

Title

Area Code and Telephone No.

Name and Address of Reporting Institution

Name of Senior Officer in Charge of the Special Credit Restraint Program

Title

Area Code and Telephone Number

Please return one copy of this report by April 18 to the Federal Reserve Bank in whose District the respondent is located.

For Internal Use Only

FR 2063d(S)
OMB No. 55-S-80002
Approved by Federal Reserve Board and OMB
March 1980

Supplement

SPECIAL CREDIT RESTRAINT PROGRAM
Finance Companies

C. STATISTICAL INFORMATION

	Amounts outstanding in thousands of dollars as of last day of					
	February '80			February '79		
	Bils.	Mils.	Thous.	Bils.	Mils.	Thous.
1. The data reported below are for your company's U.S. consolidated operations.						
a. Total accounts receivable						
b. Total business receivables (note that items (1), (2), and (3) below do not add to the total reported in this line)						
1) From U.S. addresses						
2) Loans to smaller businesses included in Item C1b.						
3) Lease financing receivables included in Item C1b						
2. The data reported below are for total business loans to U.S. addresses by your company's non-U.S. offices.	▨	▨	▨	▨	▨	▨
a. Loans by your foreign offices.						

FR 2062d

INSTRUCTIONS

Who Must Report

This report is required from any finance company with total business receivables outstanding of $1 billion or more.

Purpose of the Report

To assist in monitoring developments in credit markets and cooperation of individual companies with the voluntary Special Credit Restraint Program announced by the Board of Governors of the Federal Reserve System on March 14, 1980.

Where and When to Report

One copy of the completed report shall be filed by no later than the 10th business day after the last day of the month with the Federal Reserve Bank in whose district the respondent is located.

How to Report

All reports should be made out by typewriter or in ink.

For each question in Sections A and B, please place a check mark (✓) or an "X" in the appropriate box.

All amounts should be reported to the nearest thousand dollars as of the close of business on the last day of the month. In the event that actual data are not available, please provide estimates.

Coverage and Consolidation

Include the U.S. parent finance company and its U.S. finance company affiliates and subsidaries. Exclude commercial banks, credit unions, saving and loan associations, cooperative banks or mutual savings banks.

GENERAL DEFINITIONS

U.S.: The 50 states of the United States, the District of Columbia, Puerto Rico and U.S. territories and possessions.

Non-U.S.: Any other geographic area.

Addressee: Whether a customer is "U.S." or "non-U.S." shall be determined by the customer's principal address. A U.S. address is one in the 50 states of the United States, the District of Columbia, Puerto Rico and U.S. territories and possessions. A non-U.S. address is one in any other geographic area.

Business loans, business credit, business receivables: Loans on commercial accounts receivable; inventory loans; factoring; leasing; loans on retail installment sales (or purchases) of commercial vehicles and commercial, industrial and farm equipment; wholesale financing of consumer and business goods; dealer capital loans; multi-collateral loans; and rediscounted receivables of other finance companies. (See forms FR 2248 and FR 2248A.)

Smaller business: As a general guideline, a "smaller business" might be one whose activities are local, or at most regional, in scope; whose loan takedowns normally do not exceed $500 thousand; and whose total loans outstanding are less than $1-1/2 million. In the event that you cannot classify borrowers according to this definition, use your best judgment as to which of your business customers come closest to it.

ITEM DEFINITIONS

Item A3, Private credit demands from U.S. addressees: Include all applications or requests for loans or loan commitments from individuals and businesses. Exclude demands by the U.S. Treasury, federal agencies, and state and local governments. "U.S. addressees' are defined above under "General Definitions."

Items B3d and B4d: The statement required in Items B3d and B4d should list the following for each loan: the industry or major activity of the borrower; the purpose of the loan; the type and amount of the loan; the data of approval of the advance arrangement and takedown; and the role of your company (lead or syndicate member).

Item C1a, Total accounts receivable: Business receivables (as defined under "General Definitions"); installment paper arising from retail sales of passenger cars, mobile homes, general merchandise and other consumer goods; home improvement loans not secured by real estate; personal cash loans to individuals; loans, whatever the purpose, secured by junior liens on real estate as evidenced by junior mortgages or other instruments.

For Internal Use Only

F.R. 2083a
OMB No. 55-R-0272
Approved by Federal Reserve Board and OMB
March 1980

SPECIAL CREDIT RESTRAINT PROGRAM
Selected Corporations

Report for the Month of_______________

This report is required by law (12 U.S.C. §§1901-1909, as implemented by Executive Order 12201).

The Federal Reserve System regards the individual respondent information provided by each respondent as confidential. If it should be determined subsequently that any information collected on this form must be released, respondents will be notified.

PLEASE READ INSTRUCTIONS PRIOR TO COMPLETION OF THIS REPORT

A. The data reported below are for your company's U.S. financial and nonfinancial subsidiaries and offices, except for those that are filing this report separately.

	Amounts outstanding in thousands of dollars as of last day of					
	Current Month			Year-ago Month		
	Bils.	Mils.	Thous.	Bils.	Mils.	Thous.
1. Commercial paper issued in the United States						
a. Amount outstanding						
b. Total U.S. bank lines to support U.S. commercial paper						
2. Total indebtedness to non-U.S. entities (sum of items a, b, c, and d below):						
a. Foreign offices of U.S. banks						
b. Foreign offices of non-U.S. banks						
c. Non-U.S. affiliates (net)						
d. Other non-U.S. sources						

B. The space below is for any explanation or comment you wish to make regarding the information reported. Please indicate for each comment the number of the item to which it applies.

I certify that the information shown on this report is correct.

Authorized Signature

Name—Please Print

Title

Area Code and Telephone Number

Please return one copy of this report by April 10 to the Federal Reserve Bank in whose District the respondent is located.

Name and Address of Reporting Institution

Name of Senior Officer in charge of the Special Credit Restraint Program

Title

Area Code and Telephone Number

For Internal Use Only

FR 2082e(S)
OMB No. 55-S-80003
Approved by Federal Reserve Board and OMB
March 1980

Supplement

SPECIAL CREDIT RESTRAINT PROGRAM
Selected Corporations

A. The data reported below are for your company's U.S. financial and nonfinancial subsidiaries and offices, except for those that are filing this report separately.

	Amounts outstanding in thousands of dollars as of last day of					
	February '80			February '79		
	Bil.	Mil.	Thous.	Bil.	Mil.	Thous.
1. Commercial paper issued in the United States						
a. Amount outstanding						
b. Total U.S. bank lines to support U.S. commercial paper						
2. Total indebtedness to non-U.S. entities (sum of items a, b, c, and d below):						
a. Foreign offices of U.S. banks						
b. Foreign offices of non-U.S. banks						
c. Non-U.S. affiliates (net)						
d. Other non-U.S. sources						

INSTRUCTIONS

Who Must Report

This report is required from any finance company that has commercial paper outstanding amounting to $1 billion or more, and by any nonfinancial corporation with such outstandings of $30 million or more or with annual worldwide revenues of $2 billion or more. The report should include all of the company's U.S. financial and nonfinancial subsidiaries except those that are reporting on this form for themselves.

Purpose of the Report

To assist in monitoring developments in credit markets and in assessing reactions of lenders and borrowers to the voluntary Special Credit Restraint Program announced by the Board of Governors of the Federal Reserve System on March 14, 1980.

Where and When to Report

One copy of the completed report shall be filed by no later than the 10th business day after the last day of the month with the Federal Reserve Bank in whose district the respondent is located.

How to Report

All reports should be made out by typewriter or in ink.

Amounts should be reported to the nearest thousand dollars as of the close of business on the last day of the month. Amounts denominated in foreign currencies initially should be valued in U.S. dollars at the prevailing exchange rate at the time the transaction originally is entered into, and should be revalued periodically on a consistent basis.

DEFINITIONS

U.S. entities: Those domiciled in any of the 50 states, the District of Columbia, Puerto Rico, and U.S. territories and possessions.

Non-U.S. (or foreign) entities: Those domiciled in any other geographic area.

Commercial paper: Promissory notes of large denominations sold directly or through dealers to the investor and issued for not longer than 270 days. Includes short-term or demand "master" or "trust" notes and documented discount notes (commercial paper accompanied by an irrevocable letter of credit issued by a bank). For companies that file FR 2957b, this definition corresponds to the one used there.

Bank lines: Include regular and revolving credit lines.

U.S. banks: U.S. offices of U.S.-chartered commercial banks and U.S. branches and agencies of foreign banks.

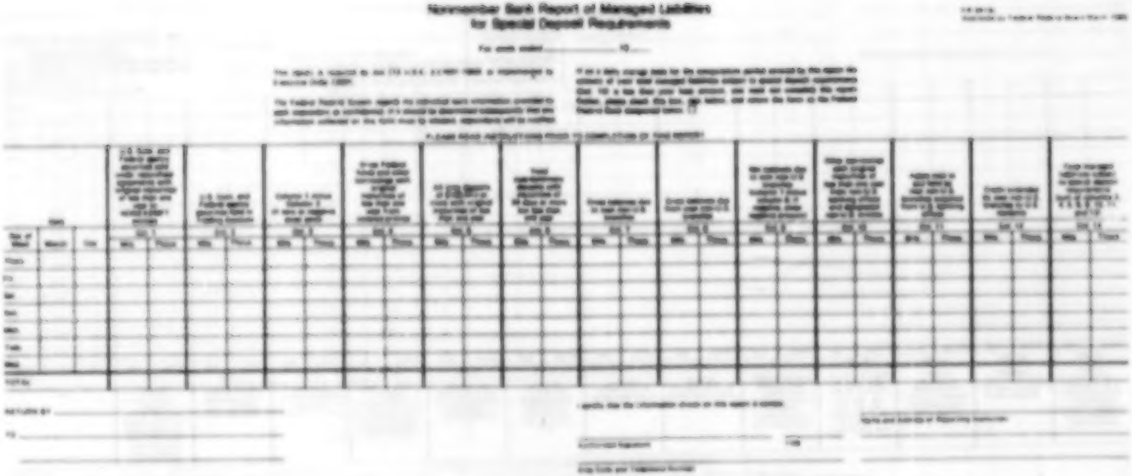
Total indebtedness: Bank loans, commercial paper, bankers acceptances, open-book credit, bonds,notes, debentures, mortgages, and other short- or long-term loans and advances from non-U.S. entities including the reporting company's non-U.S. affiliates.

Foreign offices of U.S. banks: Defined as above. Indebtedness should be shown gross of claims of the reporting company on these lenders.

Foreign offices of non-U.S. banks: Defined as above. Indebtedness should be shown gross of claims of the reporting company on these lenders.

Non-U.S. affiliates: Non-U.S. is as defined above. Amounts shown should be net of amounts owed to the reporting company by all its non-U.S. affiliates.

Other non-U.S. sources: Indebtedness to all non-U.S. (as defined above) sources of the outstanding indebtedness of the reporting company, except indebtedness reported in Items A2a, A2b and A2c. Amounts should be shown gross of claims of the reporting company on these sources.



Nonmember Bank Report of Managed Liabilities for Special Deposit Requirements

For week ended ____________ 19__

[illegible]
Approved Federal Reserve Board [illegible] 1980

Nonmember Bank Report of Managed Liabilities for Calculation of the Base for Special Deposit Requirements

This report is required by law (12 U.S.C. §§1901-1909) as implemented by Executive Order 12201.

The Federal Reserve System regards the individual bank information provided by each respondent as confidential. If it should be determined subsequently that any information collected on this form must be released, respondents will be notified.

If you have total liabilities less than $100 million, you need not complete the report. Rather, please check the box, sign below, and return the form to the Federal Reserve Bank designated below. ☐

SECTION I

PLEASE READ INSTRUCTIONS PRIOR TO COMPLETION OF THIS REPORT

Date			U.S. Govt. and Federal agency securities sold under repurchase agreements with original maturities of less than one year to NONEXEMPT entities		U.S. Govt. and Federal agency securities held in Trading Accounts		Column 1 minus Column 2 (if zero or negative enter zero)		Gross Federal funds and other borrowings with original maturities of less than one year from covered entities		All time deposits of $100,000 or more with original maturities of less than one year		Total supplementary deposits with maturities of 30 days or more but less than one year		Gross balances due to own non-U.S. branches		Gross balances due from own non-U.S. branches		Net balances due to own non-U.S. branches (column 7 minus column 8; if negative, enter negative amount)		Other borrowings with original maturities of less than one year from non-U.S. banking offices and designated non-U.S. entities		Assets sold to and held by own non-U.S. branches (acquired from U.S. banking offices)		Credit extended by own non-U.S. branches to U.S. residents		Total managed liabilities subject to special deposit requirements (algebraic sum of columns 3, 4, 5, 6, 9, 10, 11 and 12)	
			Col. 1		Col. 2		Col. 3		Col. 4		Col. 5		Col. 6		Col. 7		Col. 8		Col. 9		Col. 10		Col. 11		Col. 12		Col. 13	
Day of Week	Month	Day	Mils.	Thous.	Mils.	Thous.	Mils.	Thous.	Mils.	Thous.	Mils.	Thous.	Mils.	Thous.	Mils.	Thous.	Mils.	Thous.	Mils.	Thous.	Mils.	Thous.	Mils.	Thous.	Mils.	Thous.	Mils.	Thous.
Thurs	Feb	28																										
Fri	Feb	29																										
Sat	Mar	1																										
Sun	Mar	2																										
Mon	Mar	3																										
Tues	Mar	4																										
Wed	Mar	5																										
Thurs	Mar	6																										
Fri	Mar	7																										
Sat	Mar	8																										
Sun	Mar	9																										
Mon	Mar	10																										
Tues	Mar	11																										
Wed	Mar	12																										
TOTAL																												

CALCULATION TO DETERMINE BASE

Line 1 Total of Column 13 $________

Line 2 Divide Line 1 by 14 (to determine daily average) $________

Line 3 MANAGED LIABILITIES BASE FOR SPECIAL DEPOSIT REQUIREMENTS $________

If Line 2 is equal to or greater than zero, the base is either the amount shown on Line 2 or $100 million, whichever is larger.

If Line 2 is less than zero (that is, if Line 2 is negative), the base is the algebraic sum of Line 2 and $100 million.

RETURN BY NO LATER THAN MARCH 21, 1980

TO ________________________________

I certify that the information shown on this report (both Sections I and II) is correct.

________________________ Authorized Signature

____________ Title

________________________ Area Code and Telephone Number

________________________ Name and Address of Reporting Institution

____

____

SECTION II.

This Section must be completed only if the managed liabilities base for spec[illegible] deposit requirements (from Line 3 of Section I) is greater than $100 million. If your managed liabilities base for special deposit requirements is $100 million or [illegible]ess, you need not complete this Section. Rather, please check this box and return [illegible]is form with Section I of the report to the designated Federal Reserve Bank. ☐

Date			Gross loans to non-U.S. residents and gross balances due from non-U.S. offices of other institutions	
Day of Week	Month	Day	Mils.	Thous.
Thurs.	Feb.	28		
Fri.	Feb.	29		
Sat.	Mar.	1		
Sun.	Mar.	2		
Mon.	Mar.	3		
Tues.	Mar.	4		
Wed.	Mar.	5		
Thurs.	Mar.	6		
Fri.	Mar.	7		
Sat.	Mar.	8		
Sun.	Mar.	9		
Mon.	Mar.	10		
Tues.	Mar.	11		
Wed.	Mar.	12		
TOTAL				
DAILY AVERAGE				

For nonmember banks that have a managed liabilities base of greater than $100 million during the two-week base period of February 28, 1980 through March 12, 1980, the managed liabilities base will be reduced in computation weeks subsequent to the base period by the amount by which the bank's lowest daily average of gross loans to non-U.S. residents and gross balances due from non-U.S. offices of other institutions outstanding during any computation week beginning March 20, 1[illegible] or thereafter is lower than the daily average amount of such loans and balances outstanding during the base period as reported above. In no instance, however, will the base be reduced to less than $100 million by such decrease.

The managed liabilities base that is reported in Line 3 of Section I of this report and the daily average amount of gross loans to non-U.S. residents and gross balances due from non-U.S. offices of other entities that is reported in Section II of this report will be required for the calculation of any reduction in the managed liabilities base for all special deposits computation periods beginning March 20, 1980 or thereafter, and must be carried forward to subsequent *Supplements* to the *Nonmember Bank Report of Managed Liabilities* (FR 2413d).

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INSTRUCTIONS

Nonmember Bank Report of Managed Liabilities for Calculation of the Base for Special Deposit Requirements

and

Nonmember Bank Report of Managed Liabilities for Special Deposit Requirements

Who must report. The Nonmember Bank Report of Managed Liabilities for Calculation of the Base for Special Deposit Requirements (FR 2412y) and the Nonmember Bank Report of Managed Liabilities for Special Deposit Requirements (FR 2412c) are required for each commercial bank that is not a member of the Federal Reserve System whose total liabilities on December 31, 1979 were $150 million or more.

Purpose of the report. The base report (FR 2412y) will be used to establish the initial managed liabilities base for the calculation of special deposit requirements. The weekly special deposit report (FR 2412c) will be used to assess the special deposit requirements.

The special deposit requirement will be calculated for each seven-day computation period of Thursday through Wednesday beginning March 20, 1980. This special deposit must be held at the Federal Reserve Bank of the district in which the reporting institution is located during the seven-day maintenance periods beginning on Thursday, eight days after the close of the computation week. Each covered bank shall maintain a noninterest-bearing special deposit equal to 10 percent of the amount by which the daily average of the reporting bank's total managed liabilities during the seven-day computation period exceeds the managed liabilities base. 1/

In a computation period in which the daily average total managed liabilities subject to special deposit requirements equal or fall below your institution's base, no special deposit requirements will be applied. Subsequently, if the daily average total of such liabilities in any computation period exceeds your institution's base, special deposit requirements will again be applied.

1/ For an institution that was a net lender abroad during the base period (that is, its total managed liabilities for the base period was negative), the special deposit requirement will be applied to the amount by which the institution increases its managed liabilities over the base, even if it remains a net lender abroad during subsequent periods. For example, if a reporting institution's base was -$100 million, and it reported daily average managed liabilities during a computation week of -$25 million, the special deposit requirement will be applied to the increase in managed liabilities; that is, to $75 million [(-$25) - (-$100) = $75].

How to report. All amounts should be reported to the nearest thousand dollars as of the close of business each day. For any day on which the reporting institution was closed, report the closing balance of the preceding day.

Amounts denominated in foreign currencies should be initially valued in U.S. dollars at the prevailing exchange rate at the time the transaction originally occurs and periodically revalued on a consistent basis.

Consolidation. A consolidated report should be prepared combining appropriate accounts of the following entities: (1) the bank's head office; (2) all branches located in the 50 states of the United States or the District of Columbia; and (3) all operations subsidiaries of the bank located in the 50 states of the United States or the District of Columbia (operations subsidiaries are majority-owned subsidiaries of the bank that are separately incorporated to perform functions that the bank is empowered to perform directly). Edge Act and Agreement Corporation subsidiaries are not to be consolidated in this report.

General definitions. For purposes of this report, the terms "U.S." and "non-U.S.," which are used in the item definitions below, are defined as follows:

U.S.: The 50 states of the United States and the District of Columbia.

Non-U.S.: Any geographic area located outside the 50 states of the United States and the District of Columbia. Thus, for purposes of this report, non-U.S. includes the Commonwealth of Puerto Rico and dependencies and possessions of the United States.

ITEM DEFINITIONS

Column 1: U.S. Government and Federal agency securities sold under repurchase agreements with original maturities of less than one year to NONEXEMPT entities. Report in this column the amount outstanding of all repurchase agreements with original maturities of less than one year involving U.S. Government and Federal agency securities entered into with any NONEXEMPT entity, wherever located. The following entities are exempt:

1. a U.S. office or operations subsidiary of a bank that is a member of the Federal Reserve System;
2. a U.S. office of an Edge Act or Agreement Corporation engaged in the banking business;
3. a U.S. branch or agency of a bank organized under foreign (non-U.S.) law whose worldwide banking assets exceed $1 billion (U.S. dollars); and
4. a Federal Reserve Bank.

Repurchase agreements entered into by any reporting institution with nonexempt entities, such as nonmember banks and nonbank dealers, will not be subject to the special deposit requirement and should not be reported in this column if such transactions are intended to provide collateral to nonexempt entities in order to engage in repurchase transactions with the Federal Reserve System Open Market Account.

NOTE: If you are unable to reasonably determine from your records whether your repurchase agreements with commercial banks were made with exempt banks (the institutions listed in 1 through 3 above) or with nonexempt commercial banks and trust companies that are not members of the Federal Reserve System, you may estimate this breakdown for purposes of the base report (FR 2412y). However, if you estimate this breakdown, not less than 80 percent of your total repurchase agreements with commercial banks may be estimated to have been made with the exempt institutions listed in 1 through 3 above. Such estimates are not permitted, however, on subsequent weekly reports of managed liabilities (FR 2412c).

Repurchase agreements consist of sales of securities under a prearranged agreement to repurchase the same or similar securities at a later date. Include in this column only transactions involving U.S. Government and Federal agency securities, and obligations that are fully guaranteed as to principal and interest by the U.S. Government or a Federal agency. For the treatment of repurchase agreements involving other securities or assets of the reporting institution, refer to the instructions for completing Column 4 of this report.

Column 2: U.S. Government and Federal agency securities held in Trading Account. Report in this column the amount outstanding of U.S. Government and Federal agency securities, and other obligations that are fully guaranteed as to principal and interest by the U.S. Government or a Federal agency, held in the reporting institution's Trading Account. Trading Account securities generally refer to securities that the reporting institution regularly deals in or purchases with the intention of reselling. Securities that are held for possible resale should not be reported in this column, regardless of whether or not held in a designated Trading Account. Securities held in the Trading Account should be valued in the same manner as is used for Federal income tax purposes. In determining the amount of U.S. Government and Federal agency securities held in the Trading Account, you may include securities held in the Trading Account that have been: (a) sold under prearranged agreements to repurchase at a later date; (b) pledged against deposits or used as collateral for other liabilities; or (c) lent temporarily to other entities.

DO NOT INCLUDE in this column:

1. securities purchased under prearranged agreements to resell the securities at a later date; and
2. securities borrowed from other entities or your customer's securities held as collateral.

NOTE: Do not net short sales of securities against the Trading Account position. Thus, the amount reported in this column cannot be negative.

Column 3: Amount of Column 1 minus Column 2. Enter the amount reported in Column 1 minus the amount in Column 2. If the subtraction results in a negative amount (i.e., if the amount of Trading Account securities exceeds the amount of repurchase agreements to nonexempt entities), enter zero.

Column 4: Gross Federal funds and other borrowings with original maturities of less than one year from covered entities. Report in this column the amount outstanding of borrowings (as defined in Section B below) with original maturities of less than one year--including repurchase agreements not reported in Column 1 and gross purchases of Federal funds--from U.S. offices of the following entities:

A. Entities covered by Column 4:

1. U.S. commercial banks and trust companies that are not members of the Federal Reserve System and their operations subsidiaries;
2. a U.S. branch or agency of a bank organized under foreign (non-U.S.) law whose worldwide banking assets are $1 billion or less (U.S. dollars);
3. mutual and stock savings banks;
4. building or savings and loan associations;
5. cooperative banks;
6. credit unions;
7. U.S. Government agencies and instrumentalities, including the Federal Home Loan Bank Board, Federal Home Loan Bank, Federal Intermediate Credit Banks, Federal Land Banks, Banks for Cooperatives, the Federal Home Loan Mortgage Association, Federal Deposit Insurance Corporation, and Federal National Mortgage Association (DO NOT include borrowings from the U.S., such as Treasury tax and loan account note balances);
8. Export-Import Bank of the United States;
9. Government Development Bank of Puerto Rico;
10. Minbanc Capital Corporation;
11. securities dealers, but only when the borrowing (a) has a maturity of one day, (b) is in immediately available funds, and (c) is in connection with the clearance of securities; and
12. Edge Act Corporations not engaged in banking.

NOTE: If you are unable to reasonably determine from your records whether your borrowings from commercial banks were made with commercial banks and trust companies that are not members of the Federal Reserve System (Item 1 above), you may estimate this breakdown for purposes of the base report (FR 2412y). However, if you estimate this breakdown, not less than 80 percent of your total borrowings from commercial banks may be estimated to have been from exempt institutions (a U.S. office or operations subsidiary of a bank that is a member of the Federal Reserve System; a U.S. office of an Edge Act or Agreement Corporation; or a U.S. branch or agency of a bank organized under foreign law whose worldwide banking assets exceed $1 billion). Such estimates are not permitted, however, on subsequent weekly reports of managed liabilities (FR 2412c).

B. INCLUDE as borrowings the following obligations with original maturities of less than one year that are issued to the entities designated in Section A above:

1. gross purchases of Federal funds;
2. promissory notes, acknowledgments of advance, and similar obligations, whether secured or unsecured, whether written or oral, and whether in immediately-available, clearinghouse, or other funds;
3. repurchase agreements involving assets or securities other than securities of, or fully guaranteed by, the U.S. Government and Federal agencies;
4. mortgage-backed securities that are issued by the reporting institution and that represent sales of participation certificates in pools of one-to-four family mortgages when the reporting institution retains more than a 10 percent interest in the pool;
5. overdrawn balances in deposit accounts held at any of the entities specified in Section A above; and
6. due bills and similar obligations that are issued by the reporting institution and that involve a receipt of funds by the reporting institution to be used in its banking business.

NOTE: Due bills generally refer to obligations representing a promise to sell or deliver securities at some future date and are issued in lieu of the security to be sold or delivered at times when the security is in short supply or currently unavailable. However, due bills or similar obligations issued to any entity designated in Section A above that are not issued to obtain funds to be used by the reporting institution in its banking business should not be reported in this column. If any due bills not issued to obtain funds to be used in the banking business remain uncollateralized for more than three business days, such amount should be reported in Column 5.

EXCLUDE from this column the following obligations:

1. borrowings from any U.S. office of (a) a bank that is a member of the Federal Reserve System and the bank's operations subsidiaries, (b) an Edge Act or Agreement Corporation, or (c) a branch or agency of a bank organized under foreign law whose worldwide banking assets exceed $1 billion (U.S. dollars);
2. borrowings of the type indicated in Section B above from any entity not designated in Section A above, i.e., generally nonbanks (If of original maturity of 30 days or more but less than one year and in an amount of $100,000 or more, such borrowings are included in Column 5 of this report.);
3. borrowings from a Federal Reserve Bank;
4. loans sold with recourse;
5. mortgage indebtedness;
6. subordinated notes that meet the requirements of Section 329.1(f) of FDIC regulations;
7. borrowings from the United States, including Treasury tax and loan account note balances;
8. borrowings that are included in Column 10 of this report; and
9. funds received from sale of bankers acceptances issued or undertaken by the reporting institution that are ineligible for discount by Federal Reserve Banks. (If the remaining maturity at the time the reporting institution receives the proceeds is less than one year, such obligations are included in Column 6 of this report.)

Column 5: All time deposits of $100,000 or more with original maturities of less than one year. Report in this column the amount outstanding of all time deposits of $100,000 or more with original maturities of less than one year. Time deposits are defined as deposits that are payable on a specified date after a specified period of time from the date of deposit, or after a specified notice period, which in all cases may not be less than 30 days from the date of deposit.

INCLUDE as time deposits:

1. time certificates of deposit, whether evidenced by negotiable or non-negotiable instruments;
2. time deposits, open-account evidenced by written contracts;

3. savings certificates, notice accounts, or passbook accounts (but not savings deposits);

4. money market certificates;

5. funds received or held in escrow accounts that may be withdrawn after not less than 30 days from the date of deposit or after not less than 30 days written notice of an intended payment;

6. interest-bearing and noninterest-bearing time deposits;

7. deposits in time accounts of Individual Retirement Account (IRA) funds or Keogh Plan funds;

8. time deposits maintained as compensating balances or pledged as collateral for loans;

9. all interest paid by crediting time deposit accounts;

10. time deposit accounts at non-U.S. offices of the reporting institution when the deposit is guaranteed payable at a U.S. office in the event the non-U.S. office is precluded from making payment;

11. the liability of the reporting institution on promissory notes, acknowledgments of advance, repurchase agreements involving assets of the reporting institution other than U.S. Government or Federal agency securities, and other similar obligations that are issued in original maturities of 30 days or more but less than one year to obtain funds for use in the banking business except such obligations included in Column 4 or Column 10 of this report;

12. due bills and similar obligations undertaken by the reporting institution to sell or deliver securities, when issued primarily to obtain funds for use in the banking business and that have an original maturity of less than one year except such obligations included in Column 4 of this report; and

13. due bills and similar obligations that are issued by the reporting institution to any entity to obtain funds not to be used in the banking business of the reporting institution which have a maturity of less than one year, and which remain uncollateralized for more than three business days.

For special deposit purposes, funds kept with the bank for a stated period of one year or more under a master agreement specifying that the funds will be placed in a series of short-term certificates of deposit (CDs)--sometimes referred to as "roly-poly" CDs--should be regarded as the issuance of a series of short-term CDs by the reporting institution and not as the creation of a long-term deposit. Thus, for purposes of this report, the relevant time period is the maturity of each certificate of deposit issued under the terms of the agreement and not the expiration date of the master agreement.

EXCLUDE from time deposits the following liabilities:

1. funds accumulated in installments for the payment of installment loans (hypothecated deposits) that do not immediately reduce the unpaid balance of the loan, but that are irrevocably assigned to the reporting institution and cannot be reached by its customer or the customer's creditors;

2. funds received and credited to dealer reserve or dealer difference accounts that the reporting institution is not obligated to make available to either the dealer or the dealer's creditors;

3. funds obtained from state and municipal housing authorities under loan-to-lender programs;

4. borrowings from a Federal Reserve Bank;

5. all repurchase agreements involving U.S. Government or Federal agency securities and other obligations fully guaranteed as to principal and interest by the U.S. Government or a Federal agency;

6. all amounts included in Column 4, Column 7, and Column 10 of this report;

7. savings deposits (a deposit for which the bank merely reserves the right to require at least 30 days written notice of an intended withdrawal);

8. Christmas, vacation, and other similar club accounts;

9. NOW accounts (classified as savings deposits and thus excluded from this report);

10. matured time deposits, which are classified as demand deposits and thus excluded from this report, unless the deposit provides for automatic renewal at maturity; and

11. interest accrued but not yet paid.

Column 6: Total supplementary deposits with maturities of 30 days or more but less than one year. Report in this column the outstanding amount of supplementary deposits with remaining maturities of 30 days or more but less than one year at the time the reporting institution receives the proceeds. These supplementary deposits represent funds obtained by the reporting institution through (a) issuance of obligations by affiliates, and (b) its use of ineligible acceptances.

Include in this column the amount outstanding of the proceeds of obligations issued by the reporting bank's affiliates (as defined in 12 U.S.C. § 221a) in the form of promissory notes, acknowledgments of advance, due bills, or similar obligations (written or oral) that are supplied to the reporting institution (or its operations subsidiaries) for the latter's use in its banking business or to maintain the availability to the reporting institution of such funds.

The amount included as obligations issued by the reporting institution's affiliates should exclude:

1. funds obtained by the reporting institution through those obligations issued by affiliates that are supplied to the reporting institution by the affiliates in the form of deposits in the reporting bank;
2. obligations issued by affiliates that arise from the transfer of direct obligations of, or obligations that are fully guaranteed as to principal and interest by, the United States or any agency thereof that the affiliate is obligated to repurchase;
3. obligations of affiliates issued to and held for the account of any agency of the United States or the Government Development Bank of Puerto Rico; and
4. obligations of affiliates issued to and held for the account of a domestic banking office of another bank.

Also report in this column the outstanding amount of funds obtained by the reporting institution through its use of ineligible acceptances with remaining maturities of 30 days or more but less than one year (acceptances not eligible for discount by Federal Reserve Banks--see Section 201.4(b) of Regulation A), when the obligation is issued or undertaken by the reporting institution as a means of obtaining funds for use in its banking business (regardless of the nature of the buyer). Ineligible acceptances are sometimes referred to as finance bills.

The amounts to be reported are the funds received, and not necessarily the face amount of the ineligible acceptances issued or undertaken; therefore, the amounts outstanding reported in this column may differ from the face amounts of outstanding ineligible acceptances.

Column 7: Gross balances due to own non-U.S. branches. Report the amount outstanding of gross liabilities of the reporting institution's U.S. banking offices to non-U.S. branches of the reporting institution and to its own Edge Act Corporations not engaged in the banking business. Gross liabilities may arise from:

1. funds placed on deposit at the head office or other U.S. banking offices of the bank by non-U.S. branches whether in the form of demand or time deposits;

2. borrowings by the head office or other U.S. banking offices of the bank from non-U.S. branches;

3. sales of assets under agreements to repurchase by the head office or other U.S. banking offices to non-U.S. branches;

4. overdrawn balances in deposit accounts of the head office or other U.S. banking offices of the bank at non-U.S. branches (note that such overdrawn balances should not be treated as negative balances in Column 8);

5. other liabilities of the head office or other U.S. banking offices of the bank to non-U.S. branches of the bank, such as those resulting from clearing activities, payments related to foreign exchange transactions, bankers acceptance transactions, funds channeled to U.S. banking offices and other activities.

Column 8: Gross balances due from own non-U.S. branches. Report the amount outstanding of gross claims of the reporting institution's U.S. banking offices on non-U.S. branches of the reporting institution. Gross claims may arise from:

1. funds placed on deposit by the head office and other U.S. banking offices of the bank at non-U.S. branches, whether in the form of demand or time deposits;

2. funds advanced by the head office and other U.S. banking offices of the bank to non-U.S. branches;

3. purchases of assets under agreements to resell from non-U.S. branches;

4. overdrawn balances in deposit accounts of the bank's non-U.S. branches at the head office and other U.S. banking offices of the bank (note that such overdrawn balances should not be treated as negative balances in Column 7); and

5. other claims on the non-U.S. offices of the bank, such as those resulting from clearing activities, foreign exchange transactions, bankers acceptance transactions, unremitted branch earnings, funds channeled to non-U.S. banking offices, and other activities.

Column 9: Net balances due to own non-U.S. branches. Enter in this column the amount reported in Column 7 minus the amount in Column 8. If the subtraction results in a negative amount, enter that negative amount.

Column 10: Other borrowings with original maturities of less than one year from non-U.S. banking offices and designated non-U.S. entities. Report in this column all outstanding borrowings by the reporting institution's U.S. offices that have original maturities of less than one year and that were obtained from:

1. non-U.S. banking offices of other U.S. banks and non-U.S. banks;
2. foreign national governments that perform functions similar to those performed by the Federal government of the U.S. (state, provincial, regional, municipal, or other regional governmental units should not be included as foreign national governments);
3. international entities of which the United States is a member; and
4. other foreign, international or supranational entities exempt from interest rate limitations under Section 329.3(g)(3) of FDIC regulations.

INCLUDE as borrowings:

1. promissory notes, acknowledgments of advance, and similar instruments, regardless of the terminology used to describe the borrowings (including items that are referred to as "Federal funds");
2. repurchase agreements involving assets other than U.S. Government and Federal agency securities;
3. overdrawn balances at non-U.S. banking offices of other banks; and
4. due bills or similar obligations that remain uncollateralized for more than three business days from the date of issue.

Column 11: Assets sold to and held by own non-U.S. branches acquired from U.S. banking offices. Report in this column amounts received for assets sold outright to, and still held by, the bank's own non-U.S. branches and own Edge Act Corporations not engaged in the banking business. Include such assets as:

1. loans and securities sold outright by U.S. banking offices of the bank to non-U.S. branches; and
2. participations in loans or other assets sold to the bank's non-U.S. branches.

DO NOT INCLUDE in this column sales of assets under agreements to repurchase by U.S. banking offices to the bank's non-U.S. branches. Such transactions should be reported in Column 7. The amount reported here includes assets that are claims on both U.S. and non-U.S. residents.

Column 12: Credit extended by own non-U.S. branches to U.S. residents. Report in this column the amount of credit extended directly by the reporting institution's non-U.S. branches and its own Edge Act Corporations not engaged in the banking business to U.S. residents. However, if the amount of credit extended to non-U.S. residents by any particular non-U.S. branch or Edge Act Corporation did not exceed $1 million at any time during the computation period, the amount for that branch should not be reported. In addition, if the aggregate amount of credit extended to any particular U.S. resident by all non-U.S. branches did not exceed $100,000, the amount of credit extended to that U.S. resident should not be reported. Also, exclude from this item:

1. amounts representing credit to U.S. residents acquired from U.S. banking offices of the reporting institution (included in Column 11 of this report);
2. net balances at the reporting institution's non-U.S. branches due from its domestic offices;
3. credit extended to member banks, domestic Edge Act and Agreement Corporations engaged in the banking business, or to U.S. branches and agencies of non-U.S. banks; and
4. credit exended to a non-U.S. branch, office, subsidiary, or affiliate controlled by one or more U.S. organizations if the proceeds of the credit will be used in its non-U.S. business.

Column 13: Total liabilities subject to marginal reserve requirements. Algebraic sum of Columns 3, 4, 5, 6, 9, 10, 11, and 12. This amount may be negative. If this amount is negative, enter the negative amount.

* * * * *

THE FOLLOWING ITEM APPEARS ONLY ON THE FR 2412y

Section II: Gross loans to non-U.S. residents and gross balances due from non-U.S. offices of other institutions. Report in this column the total of gross loans to non-U.S. residents and gross balances due from non-U.S. offices of other institutions. For purposes of this report, a non-U.S. resident is defined to include:

1. any individual residing (at the time the credit is extended) outside the 50 states of the United States or the District of Columbia;

2. any corporation, partnership, association or other entity organized outside the 50 states of the United States or the District of Columbia; and

3. any branch or office of any other entity, wherever organized, that is located outside the 50 states of the United States or the District of Columbia.

Credit extended to a U.S. branch, office, subsidiary, affiliate or other U.S. establishment controlled by one or more non-U.S. corporations will not be deemed to be credit extended to non-U.S. residents if the proceeds will be used in its U.S. business or that of other U.S. affiliates of the controlling non-U.S. corporation.

Foreign offices of other institutions includes the following:

1. any banking office of a bank organized under domestic or foreign law that is located outside the 50 states of the United States and the District of Columbia;

2. foreign national governments (including agencies and instrumentalities thereof, such as foreign central banks, exchange stabilization funds, monetary agencies and currency boards) that perform functions similar to those performed by the Federal government of the U.S. (but not state, provincial or other regional governmental entities); and

3. any international organization of which the United States is a member, such as the International Bank for Reconstruction and Development (World Bank), International Monetary Fund, and the Inter-American Development Bank, and other foreign, international, or supranational entities exempt from interest rate limitations under Section 329.3(g)(3) of FDIC regulations.

For purposes of this report, gross loans to non-U.S. residents include all credit extended directly to non-U.S. residents by U.S. offices of a reporting nonmember bank. Gross balances due from foreign offices of other institutions may arise from the following:

1. funds placed on deposit at any covered non-U.S. entity, whether payable on demand or at the expiration of a specified maturity;

2. funds advanced by the reporting institution that result in a claim against any covered non-U.S. entity;

3. sales of assets (including sales of participations in assets) to any covered non-U.S. entity;

4. purchases of assets under agreements to resell from any covered non-U.S. entity;

5. overdrawn balances in deposit accounts held by the reporting institution for any covered non-U.S. entity; and

6. other claims on any covered non-U.S. entity, such as those resulting from clearing activities, foreign exchange transactions, bankers acceptance transactions, and other activities.

Nonmember banks should EXCLUDE loans to and balances due from their own non-U.S. branches which are reported in Column 8 of the Nonmember Bank Report of Managed Liabilities for Special Deposit Requirements (FR 2412c).

FR 2412d
Approved by Federal Reserve Board March 1980

Supplement to the Nonmember Bank Report Managed Liabilities for Special Deposit Requirements

For Week Ended ______________, 19___

This report is required by law (12 U.S.C. §§1901-1909) as implemented by Executive Order 12201.

The Federal Reserve System regards the individual bank information provided by each respondent as confidential. If it should be determined subsequently that any information collected on this form must be released, respondents will be notified.

If your managed liabilities base for the calculation of special deposit requirements is $100 million or less, you need not complete this supplement. Rather, please check this box, sign below, and return this report to the Federal Reserve Bank designated below . . . . ☐

PLEASE READ INSTRUCTIONS PRIOR TO COMPLETING THIS REPORT

	Date		Gross loans to non-U.S. residents and gross balances due from non-U.S. offices of other institutions	
			Column I	
Day of Week	Month	Day	Mils.	Thous.
Thurs.				
Fri.				
Sat.				
Sun.				
Mon.				
Tues.				
Wed.				
TOTAL				
DAILY AVERAGE				

	Mils.	Thous.
1. Managed liabilities base for special deposit requirements (as calculated for the period February 28–March 12, 1980 and reported on Line 3 of the FR 2412y)		
2. Daily average of gross loans to non-U.S. residents and balances due from non-U.S. offices of other institutions for the period February 28–March 12, 1980 (as reported in Section II of the FR 2412y)		
3. Daily average of gross loans to non-U.S. residents and balances due from non-U.S. offices of other institutions for the current computation week (from Column I above)		
4. Line 2 minus Line 3 (if negative, enter zero)		
5. Amount on Line 4 rounded down to largest, lower multiple of $2 million (for example, if the entry on Line 4 was $53,525, Line 5 would be $52,000)		
6. Line 1 minus Line 5 (if less than $100 million, enter $100 million)		
7. Managed liabilities base for previous computation week (from Line 8 of previous week's supplemental report)		
8. Managed liabilities base for the current computation week (enter the amount on Line 6 or Line 7, whichever is *smaller*)		

I certify that the information shown on this supplement is correct.

____
Name and Address of Reporting Institution

____________________________ __________
Authorized Signature Title

____
Area Code and Telephone Number

RETURN BY ________________________ TO ________________________

INSTRUCTIONS FOR THE SUPPLEMENT TO THE REPORT OF MANAGED LIABILITIES FOR SPECIAL DEPOSIT REQUIREMENTS

Who must report. This report is required from nonmember banks whose managed liabilities base for the calculation of special deposit requirements is greater than $100 million.

Purpose of the report. This report will be used to adjust the managed liabilities base for the calculation of special deposit requirements by the amount by which the reporting institution's lowest daily average of gross loans to non-United States residents and gross balances due from non-U.S. offices of other institutions outstanding during any computation week beginning March 20, 1980 or thereafter is lower than the daily average amount of such loans and balances outstanding during the period of February 28 through March 12, 1980. Increases in such loans and balances will have no effect on an institution's managed liabilities base.

This report must be filed only by covered institutions that have a managed liabilities base in excess of $100 million. In no instance will the downward adjustment in the managed liabilities base reduce the base to an amount less than $100 million.

How to report. All amounts should be reported to the nearest thousand dollars as of the close of business each day. For any day in which the reporting institution was closed, report the closing balance of the preceding day.

Amounts denominated in foreign currencies should be initially valued in U.S. dollars at the prevailing exchange rate at the time the transaction orginally occurs and should be periodically revalued on a consistent basis.

Consolidation. The consolidation method is identical to that used for the Nonmember Bank Report of Managed Liabilities for Special Deposit Requirements (FR 2412c).

General definitions. For purposes of this report, the following terms are defined as follows:

U.S.: The 50 states of the United States and the District of Columbia.

Non-U.S. (foreign): Any geographic area located outside the 50 states of the United States and the District of Columbia. Thus, for purposes of this report, non-U.S. includes Puerto Rico and U.S. territories and possessions.

For additional definitions, refer to the instructions for completing the Nonmember Bank Report of Managed Liabilities for Special Deposit Requirements (FR 2412c) or Federal Reserve Board Regulation D (12 C.F.R. 204).

ITEM DEFINITIONS

Columns 1: Gross loans to non-U.S. residents and gross balances due from non-U.S. offices of other institutions. Report in this column the amount outstanding on each day covered by this report of gross loans to non-United States residents and gross balances due fron non-U.S. offices of other institutions. For purposes of this report, a non-U.S. resident is defined to include:

1. any individual residing (at the time the credit is extended) outside the 50 states of the United States or the District of Columbia;

2. any corporation, partnership, association or other entity organized outside the 50 states of the United States or the District of Columbia; and

3. any branch or office of any other entity, wherever organized, that is located outside the 50 states of the United States or the District of Columbia.

Credit extended to a U.S. branch, office, subsidiary, affiliate or other U.S. establishment controlled by one or more non-U.S. corporations will not be deemed to be credit extended to non-U.S. residents if the proceeds will be used in its U.S. business or that of other U.S. affiliates of the controlling non-U.S. corporation.

Foreign offices of other institutions includes the following:

1. any banking office of a bank organized under domestic or foreign law that is located outside the 50 states of the United States and the District of Columbia;

2. foreign national governments (including agencies and instrumentalities thereof, such as foreign central banks, exchange stabilization funds, monetary agencies and currency boards) that perform functions similar to those performed by the Federal government of the U.S. (but not state, provincial, or other regional governmental entities); and

3. any international organization of which the United States is a member (such as the International Bank for Reconstruction and Development (World Bank), International Monetary Fund, and the Inter-American Development Bank), and other foreign, international or supranational entities exempt from interest rate limitations under Section 329.3(g)(3) of FDIC regulations.

For purposes of this report, gross loans to non-U.S. residents includes all credit extended directly to non-U.S. residents by U.S. offices of a reporting nonmember bank. Gross balances due from foreign offices of other institutions may arise from the following:

1. funds placed on deposit at any covered non-U.S. entity, whether payable on demand or at the expiration of a specified maturity;
2. funds advanced by the reporting institution that result in a claim against any covered non-U.S. entity;
3. sales of assets (including sales of participations in assets) to any covered non-U.S. entity;
4. purchases of assets under agreements to resell from any covered non-U.S. entity.
5. overdrawn balances in deposit accounts held by the reporting institution for any covered non-U.S. entity; and
6. other claims on any covered non-U.S. entity, such as those resulting from clearing activities, foreign exchange transactions, bankers acceptance transactions, and other activities.

Nonmember banks should EXCLUDE loans to and balances due from own non-U.S. branches which are reported in Column 8 of the Nonmember Bank Report of Managed Liabilities for Special Deposit Requirements (FR 2412c).

FR 2414a
Approved by Federal Reserve Board March 1980

Supplement to the Report of of Managed Liabilities for Marginal Reserve Requirements

For Week Ended ____________, 19___

This report is required by law [12 U.S.C. §248(a)].

The Federal Reserve System regards the individual bank information provided by each respondent as confidential. If it should be determined subsequently that any information collected on this form must be released, respondents will be notified.

If your managed liabilities base for the calculation of marginal reserve requirements is $100 million or less, you need not complete this supplement. Rather, please check this box, sign below, and return this report to the Federal Reserve Bank designated below ☐

PLEASE READ INSTRUCTIONS PRIOR TO COMPLETING THIS REPORT

Date			Gross loans to non-U.S. residents and gross balances due from non-U.S. offices of other institutions	
			Column I	
Day of Week	Month	Day	Mils.	Thous.
Thurs.				
Fri.				
Sat.				
Sun.				
Mon.				
Tues.				
Wed.				
TOTAL				
DAILY AVERAGE				

	Mils.	Thous.
1. Adjusted managed liabilities base for marginal reserve requirements (as calculated for the period March 6-12, 1980 and reported on Line 7 of the FR 2414 z)	$	
2. Daily average of gross loans to non-U.S. residents and balances due from non-U.S. offices of other institutions for the period March 6-12, 1980 (as reported on Line 4 of the FR 2414z)		
3. Daily average of gross loans to non-U.S. residents and balances due from non-U.S. offices of other institutions for the current computation week (from Column I above).		
4. Line 2 minus Line 3 (if negative, enter zero)		
5. Amount on line 4 rounded down to largest, lower multiple of $2 million (for example, if the entry on Line 4 was $53,526, Line 5 would be $52,000)		
6. Line 1 minus Line 5 (if less than $100 million, enter $100 million)		
7. Managed liabilities base for previous computation week (from Line 8 of previous week's supplemental report)		
8. Managed liabilities base for the current computation week (enter the amount on Line 6 or Line 7, whichever is *smaller*)		

I certify that the information shown on this supplement is correct.

____
Name and Address of Reporting Institution

____
Authorized Signature   Title

____

____
Area Code and Telephone Number

____

RETURN BY ______________________________

TO ______________________________

INSTRUCTIONS FOR THE SUPPLEMENT TO THE REPORT OF MANAGED LIABILITIES FOR MARGINAL RESERVE REQUIREMENTS

Who must report. This report is required from each of the following institutions whose managed liabilities base for the calculation of marginal reserve requirements is greater than $100 million:

1. member banks;
2. Edge Act or Agreement Corporations engaged in the banking business;
3. families of U.S. branches and agencies of a bank organized under foreign (non-U.S.) law that have consolidated worldwide banking assets of more than $1 billion (U.S. dollars). For purposes of this report, a foreign (non-U.S.) bank family is defined to be all U.S. branches and agencies of the foreign parent bank and of its majority-owned foreign banking subsidiaries.

Purpose of the report. This report will be used to adjust the managed liabilities base for the calculation of marginal reserve requirements by the amount by which the reporting institution's lowest daily average of gross loans to non-United States residents and gross balances due from non-U.S. offices of other institutions outstanding during any computation week beginning March 20, 1980 or thereafter is lower than the daily average amount of such loans and balances outstanding during the period of March 6-12, 1980. Increases in such loans and balances will have no effect on an institution's managed liabilities base.

This report must be filed only by covered institutions that have a managed liabilities base in excess of $100 million. In no inctance will the downward adjustment in the managed liabilities base reduce the base to an amount less than $100 million.

How to report. All amounts should be reported to the nearest thousand dollars as of the close of business each day. For any day in which the reporting institution was closed, report the closing balances of the preceding day.

Amounts denominated in foreign currencies should be initially valued in U.S. dollars at the prevailing exchange rate at the time the transaction orginally occurs and should be periodically revalued on a consistent basis.

Consolidation. The consolidation method is identical to that used for the Report of Managed Liabilities for Marginal Reserve Requirements (FR 2413c or FR 2414c, as appropriate).

General definitions. For purposes of this report, the following terms are defined as follows:

U.S.: The 50 states of the United States and the District of Columbia.

Non-U.S. (foreign): Any geographic area located outside the 50 states of the United States and the District of Columbia. Thus, for purposes of this report, non-U.S. includes Puerto Rico and U.S. territories and possessions.

For additional definitions, refer to the instructions for completing the Report of Managed Liabilities for Marginal Reserve Requirements (FR 2413c or FR 2414c) or Federal Reserve Board Regulation D (12 C.F.R. 204).

ITEM DEFINITIONS

Columns 1: Gross loans to non-U.S. residents and gross balances due from non-U.S. offices of other institutions. Report in this column the amount outstanding on each day covered by this report of gross loans to non-United States residents and gross balances due fron non-U.S. offices of other institutions. For purposes of this report, a non-U.S. resident is defined to include:

1. any individual residing (at the time the credit is extended) outside the 50 states of the United States or the District of Columbia;

2. any corporation, partnership, association or other entity organized outside the 50 states of the United States or the District of Columbia; and

3. any branch or office of any other entity, wherever organized, that is located outside the 50 states of the United States or the District of Columbia.

Credit extended to a U.S. branch, office, subsidiary, affiliate or other U.S. establishment controlled by one or more non-U.S. corporations will not be deemed to be credit extended to non-U.S. residents if the proceeds will be used in its U.S. business or that of other U.S. affiliates of the controlling non-U.S. corporation.

Foreign offices of other institutions includes the following:

1. any banking office of a bank organized under domestic or foreign law that is located outside the 50 states of the United States and the District of Columbia;

2. foreign national governments (including agencies and instrumentalities thereof, such as foreign central banks, exchange stabilization funds, monetary agencies and currency boards) that perform functions similar to those performed by the Federal government of the U.S. (but not state, provincial, or other regional governmental entities); and

3. any international organization of which the United States is a member (such as the International Bank for Reconstruction and Development (World Bank), International Monetary Fund, and the Inter-American Development Bank), and other foreign, international or supranational entities exempt from interest rate limitations under Regulation Q [12 C.F.R. 217.3(g)(3)].

For purposes of this report, gross loans to non-U.S. residents includes all credit extended directly to non-U.S. residents by U.S. offices of a reporting member bank, Edge Act or Agreement Corporation, or a foreign bank family member. Gross balances due from foreign offices of other institutions may arise from the following:

1. funds placed on deposit at any covered non-U.S. entity, whether payable on demand or at the expiration of a specified maturity;

2. funds advanced by the reporting institution that result in a claim against any covered non-U.S. entity;

3. sales of assets (including sales of participations in assets) to any covered non-U.S. entity;

4. purchases of assets under agreements to resell from any covered non-U.S. entity;

5. overdrawn balances in deposit accounts held by the reporting institution for any covered non-U.S. entity; and

6. other claims on any covered non-U.S. entity, such as those resulting from clearing activities, foreign exchange transactions, bankers acceptance transactions, and other activities.

Member banks and Edge Act or Agreement Corporations should EXCLUDE loans to and balances due from own non-U.S. branches which are reported in Column 8 of the Member Bank Report of Managed Liabilities for Marginal Reserve Requirements (FR 2414c). Families of U.S. branches and agencies of foreign banks should EXCLUDE loans to and balances due from parent and other designated non-U.S. affiliates which are reported in Column 8 of the Agency and Branch Report of Managed Liabilities for Marginal Reserve Requirements (FR 2413c).

FR 2414e
Approved by Federal Reserve Board March 1980

Supplementary Information for Calculation of the Managed Liabilities Base for Marginal Reserve Requirements

This report is required by law (12 U.S.C. §248(a)).

The Federal Reserve System regards the information provided by each respondent as confidential. If it should be determined subsequently that any information collected on this form must be released, respondents will be notified.

If your managed liabilities base for the calculation of marginal reserve requirements is $100 million or less, you need not complete the entire report. Rather, please check this box, sign below, and return this report to the Federal Reserve Bank designated below. ☐

SECTION I

PLEASE READ INSTRUCTIONS PRIOR TO COMPLETING THIS REPORT

Date				Gross loans to non-U.S. residents and gross balances due from non-U.S. offices of other institutions	
				Col. 1	
Day of Week	Month	Day	Year	Mils	Thous
Thurs	Sept.	13	1979		
Fri	Sept.	14	1979		
Sat	Sept.	15	1979		
Sun	Sept.	16	1979		
Mon	Sept.	17	1979		
Tues	Sept.	18	1979		
Wed	Sept.	19	1979		
Thurs	Sept.	20	1979		
Fri	Sept.	21	1979		
Sat	Sept.	22	1979		
Sun	Sept.	23	1979		
Mon	Sept.	24	1979		
Tues	Sept.	25	1979		
Wed	Sept.	26	1979		
TOTAL					
DAILY AVERAGE					

Date				Gross loans to non-U.S. residents and gross balances due from non-U.S. offices of other institutions	
				Col. 2	
Day of Week	Month	Day	Year	Mils	Thous
Thurs	Mar.	6	1980		
Fri	Mar.	7	1980		
Sat	Mar.	8	1980		
Sun	Mar.	9	1980		
Mon	Mar.	10	1980		
Tues	Mar.	11	1980		
Wed	Mar.	12	1980		
TOTAL					
DAILY AVERAGE					

SECTION II

	Mils	Thous
1. Managed liabilities base for marginal reserve requirements as of two week period September 13-26, 1979 (from Line 3 of FR 2413c or 2414c, as appropriate)		
2. 93 percent of Line 1 (if less than $100 million, enter $100 million)		
3. Daily average of gross loans to non-U.S. residents and balances due from non-U.S. offices of other institutions for two-week period September 13-26, 1979 (from Section I, Column 1 above)		
4. Daily average of gross loans to non-U.S. residents and balances due from non-U.S. offices of other institutions for one week period March 6-12, 1980 (from Section I, Column 2 above)		
5. Decrease in daily average of gross loans to non-U.S. residents and gross balances due from non-U.S. offices of other institutions between the periods September 13-26, 1979 and March 6-12, 1980 (Line 3 minus Line 4; if negative, enter zero)		
6. Line 1 minus Line 5 (if less than $100 million, enter $100 million)		
7. Adjusted managed liabilities base for marginal reserve requirements (enter the amount on Line 2 or Line 6, whichever is smaller)		

The adjusted managed liabilities base shown in Line 7 will be further reduced by the amount by which the bank's lowest daily average of gross loans to non-U.S. residents and gross balances due from non-U.S. offices of other institutions outstanding during any computation week beginning March 20, 1980 or thereafter is lower than the daily average amount of such loans and balances outstanding during the period of March 6-12, 1980 (as reported in Section I). In no instance, however, will the base be reduced to less than $100 million by such decreases. The adjusted managed liabilities base that is reported in Line 7 above and the daily average amount of gross loans to non-U.S. residents and gross balances due from non-U.S. offices of other institutions for the week of March 6-12, 1980 that is reported in Line 4 above will be required for the calculation of any further reduction in the adjusted managed liabilities base for all reserve computation periods beginning March 20, 1980 and thereafter, and must be carried forward to subsequent Supplements to the Report of Managed Liabilities for Marginal Reserve Requirements (FR 2414a).

I certify that the information shown on this report is correct.

Name and Address of Reporting Institution

Authorized Signature Title

Area Code and Telephone Number

RETURN BY MARCH 25, 1980 TO

INSTRUCTIONS FOR SUPPLEMENTARY INFORMATION FOR CALCULATION OF THE MANAGED LIABILITIES BASE FOR MARGINAL RESERVE REQUIREMENTS

Who must report. This report is required from each of the following institutions whose managed liabilities base for the calculation of marginal reserve requirements is greater than $100 million:

1. member banks;
2. Edge Act or Agreement Corporations engaged in the banking business;
3. families of U.S. branches and agencies of a bank organized under foreign (non-U.S.) law that have consolidated worldwide banking assets of more than $1 billion (U.S. dollars). For purposes of this report, a foreign (non-U.S.) bank family is defined to be all U.S. branches and agencies of the foreign parent bank and of its majority-owned foreign banking subsidiaries.

Purpose of the report. This report will be used to adjust the managed liabilities base for the calculation of marginal reserve requirements as previously established during the two-week period of September 13-26, 1979. The Federal Reserve Board has acted to reduce the amount of an institution's managed liabilities base by the greater of (1) 7 percent of the current base, or (2) the amount of decrease in the institution's daily average gross loans to non-United States residents and gross balances due from non-U.S. offices of other institutions between the September 13-26, 1979 base period and the statement week ended March 12, 1980.

This report will establish a reduced base amount of managed liabilities for all institutions whose previous base amount was greater than $100 million. In no instance will the base amount for any of these institutions be reduced to less than $100 million. The revised base amount of managed liabilities will become effective with the reserve computation period beginning March 20, 1980. The amount of the adjusted managed liabilities base, as established on this report, will be further reduced by the amount by which the reporting institution's lowest daily average of gross loans to non-U.S. residents and gross balances due from non-U.S. offices of other institutions outstanding during any computation week beginning March 20, 1980 or thereafter is lower than the daily average amount of such loans and balances outstanding during the period of March 6-12, 1980 (as reported on this report). Increases in such loans and balances will have no effect on an institution's managed liabilities base.

How to report. All amounts should be reported to the nearest thousand dollars as of the close of business each day. For any day in which the reporting institution was closed, report the closing balances of the preceding day.

Amounts denominated in foreign currencies should be initially valued in U.S. dollars at the prevailing exchange rate at the time the transaction orginally occurs and should be periodically revalued on a consistent basis.

Consolidation. The consolidation method is identical to that used for the *Report of Managed Liabilities for Marginal Reserve Requirements* (FR 2413c or FR 2414c, as appropriate).

General definitions. For purposes of this report, the following terms are defined as follows:

U.S.: The 50 states of the United States and the District of Columbia.

Non-U.S. (foreign): Any geographic area located outside the 50 states of the United States and the District of Columbia. Thus, for purposes of this report, non-U.S. includes Puerto Rico and U.S. territories and possessions.

For additional definitions, refer to the instructions for completing the *Report of Managed Liabilities for Marginal Reserve Requirements* (FR 2413c or FR 2414c) or Federal Reserve Board Regulation D (12 C.F.R. 204).

ITEM DEFINITIONS

Columns 1 and 2: Gross loans to non-U.S. residents and gross balances due from non-U.S. offices of other institutions. Report in these columns the amount outstanding on each day covered by this report of gross loans to non-United States residents and gross balances due from non-U.S. offices of other institutions. For purposes of this report, a non-U.S. resident is defined to include:

1. any individual residing (at the time the credit is extended) outside the 50 states of the United States or the District of Columbia;
2. any corporation, partnership, association or other entity organized outside the 50 states of the United States or the District of Columbia; and
3. any branch of office of any other entity, wherever organized, that is located outside the 50 states of the United States or the District of Columbia.

Credit extended to a U.S. branch, office, subsidiary, affiliate or other U.S. establishment controlled by one or more non-U.S. corporations will not be deemed to be credit extended to non-U.S. residents *if* the proceeds will be used in its U.S. business or that of other U.S. affiliates of the controlling non-U.S. corporations.

Foreign offices of other institutions includes the following:

1. any banking office of a bank organized under domestic or foreign law that is located outside the 50 states of the United States and the District of Columbia;

2. Foreign national governments (including agencies and instrumentalities thereof, such as foreign central banks, exchange stabilization funds, monetary agencies and currency boards) that perform functions similar to those performed by the Federal government of the U.S. (but not state, provincial, or other regional governmental entities); and

3. any international organization of which the United States is a member (such as the International Bank for Reconstruction and Development (World Bank), International Monetary Fund, and the Inter-American Development Bank), and other foreign, international, or supranational entities exempt from interest rate limitations under Regulation Q (12 C.F.R. 217.3(g)(3).

For purposes of this report, gross loans to non-U.S. residents includes all credit extended directly to non-U.S. residents by U.S. offices of a reporting member bank, Edge Act or Agreement Corporation, or a foreign bank family member. Gross balances due from foreign offices of other institutions may arise from the following:

1. funds placed on deposit at any covered non-U.S. entity, whether payable on demand or at the expiration of a specified maturity;

2. funds advanced by the reporting institution that result in a claim against any covered non-U.S. entity;

3. sales of assets (including sales of participations in assets) to any covered non-U.S. entity;

4. purchases of assets under agreements to resell from any covered non-U.S. entity;

5. overdrawn balances in deposit accounts held by the reporting institution for any covered non-U.S. entity; and

6. other claims on any covered non-U.S. entity, such as those resulting from clearing activities, foreign exchange transactions, bankers acceptance transactions, and other activities.

Member banks and Edge Act or Agreement Corporations should EXCLUDE loans to and balances due from own non-U.S. branches which are reported in Column 8 of the Member Bank Report of Managed Liabilities for Marginal Reserve Requirements (FR 2414c). Families of U.S. branches and agencies of foreign non-U.S. affiliates which are reported in Column 8 of the Agency and Branch Report of Managed Liabilities for Marginal Reserve Requirements (FR 2413c).

Mr. LaFalce. All right, I have interrupted you enough. Would you please outline for me the new program that you are announcing now?

Mr. Schultz. We have been working very hard in recent weeks to try to identify the areas of the economy that are under the greatest pressure. Again, as I have said, we are trying to move through this period as rapidly as possible because it is our judgment, after meeting with a lot of people in small business, that basically their feeling is that they are under a tremendous amount of pressure and pain. They can stand that pressure and pain for a short period of time. But, if it stretches out for a long period of time, they are in deep trouble.

So, our whole policy is geared to trying to move through this period as rapidly as possible. The problems people have encountered are a function of two things—the availability of credit and the cost of credit.

We are trying——

Mr. LaFalce. It is primarily the cost. The availability has not really been that much of a problem; it has been the cost. Correct?

Mr. Schultz. It depends. In certain areas it has been availability. In certain agricultural areas, they have a serious availability problem for both their agricultural needs and their small business.

Rural banks in this particular cycle are heavily loaned up, in contrast to 1974, when the money center banks were heavily loaned up, the rural banks had low loan deposit ratios. This time it is the reverse.

So, what we are doing is announcing this morning a program which will be geared to all banks under $100 million in assets and any bank over $100 million that has heavy seasonal credit needs. It will say that, if you are a bank in that category, if your loan deposit ratio is 68 percent, that we will extend credit under very simple kinds of procedures. Again, if this thing is done, it has to be done rapidly. It cannot be complex because the banks will not use it. We are instituting very simple procedures. This is basically an extension of our seasonal credit program, but it is made much, much simpler and much more liberal. What we have said is that, if you qualify under those terms, we will grant you a credit line for 70 percent of the increases in loans that you make over and above your present lend of loans.

Mr. LaFalce. A credit line for 70 percent of what?

Mr. Schultz. Of the increase in loans that that bank makes.

And up to a maximum of 5 percent of their total loans. For instance, if it is a $100 million bank, that would be an additional $5 million. Under certain special circumstances, if a bank——

Mr. LaFalce. Wait. For 70 percent of the increase in loans that the bank makes up to a maximum of——

Mr. Schultz. Five percent of their total loan portfolio.

Mr. LaFalce. OK.

Mr. Schultz. In certain circumstances that can be extended further.

And we will give them that money at the basic discount rate of 13 percent.

And we are saying to them that this money is to be used for loans for small business and agriculture.

Now, we considered——

Mr. LaFalce. So, they are going to be able to get that money at 13 percent.

Mr. **Schultz.** That is right.

Mr. **LaFalce.** But they have got to use that money exclusively for small business and agricultural purposes.

Mr. **Schultz.** That is correct.

There really, I think, is not a serious——

Mr. **LaFalce.** How much do you think they will be able to lend it out at? Fourteen?

Mr. **Schultz.** That will depend upon the bank, Mr. Chairman.

I met with a group of Iowa bankers yesterday. I was asking them questions about the program in a very general way. They are presently making their loans at somewhere between 15 and 17 percent. Now, other banks may not be able to make the loans at that level, but I would not think that would be far off.

Mr. **LaFalce.** So, you think that with the special discount you should be able to offer the loan at from 15 percent to——

Mr. **Schultz.** If a banker is trying to take care of the needs of his community—after all, good banking does that—I think he will have a tendency to make the loans below prime.

Mr. **LaFalce.** Well, you know, prime is now, what, 19 to 20; it depends.

Mr. **Schultz.** As you are well aware, a good many small businesses are paying more than prime.

Mr. **LaFalce.** Oh, yes. They are paying around 23 percent.

Are you suggesting, though, that with this new program those who are taking advantage of it will be able to get a loan for roughly 15 percent rather than, say, 22 or 23 percent?

Mr. **Schultz.** It will depend upon the bank, Congressman, and——

Mr. **LaFalce.** But that is your purpose; correct?

Mr. **Schultz.** Our purpose is to do two things: to make more money available for small business and farmers; and to make it available at a lower rate.

Mr. **LaFalce.** You must have projected the total amount of money that you would put in circulation at this 13 percent discount rate; correct?

Mr. **Schultz.** We have attempted to look at those figures. Frankly, any figure that we would be able to give you would be right off the wall.

Mr. **LaFalce.** Well, how about giving it off the wall?

Mr. **Schultz.** Well, I will give you the parameters of what you are talking about here.

The banks that would be affected by this program presently have loans outstanding of approximately $210 billion. Now, we would anticipate that not all of those would take advantage of the program—that there are banks in some areas that would not have customers who need the money.

Mr. **LaFalce.** So, it would be $10.5 billion?

Mr. **Schultz.** No, it would not be. It would be less than that because that is the amount in banks with $100 million or less in loans. Now, you apply the loan-deposit ratio criteria and you are talking about half of the banks. So, you are talking about banks with $100, maybe $110 billion of loans.

So, if you take 5 percent of that, you are talking about $5 billion. But, again, there are many factors that would affect borrowings, such as the question of what their credit needs are.

So, we really do not know. Our guess is that you are talking about potential credit availability of perhaps \$1 to \$3 billion, as a practical matter.

Remember, this is supposed to be something that takes place fairly quickly. It is a seasonal kind of credit thing. It is for increases in loans. Not all banks are going to increase their loans.

Mr. LAFALCE. And that is going to be effective as of today?

Mr. SCHULTZ. That is correct.

Mr. LAFALCE. OK, fine.

Do you presently have in your files an identification of those banks that would be eligible?

Mr. SCHULTZ. Congressman, the best figures that we have are slightly over 6,000 banks will be eligible.

Mr. LAFALCE. Right. But, I mean, do you have those banks identified as such?

Mr. SCHULTZ. No, we do not.

It is a major job to just try to figure out how many are involved.

Mr. LAFALCE. Why did you focus this program—is this the totality of the new program you are announcing today?

Mr. SCHULTZ. Yes.

Mr. LAFALCE. Why did you focus this new program so much on banks and then indirectly by passthrough to the small business community and the agricultural sector? Would it make any difference if we had this special program to be used through larger banks so long as that larger bank was using that new money exclusively for small business and agricultural purposes?

Mr. SCHULTZ. The larger banks have access to money if they need it.

I think there has been some misunderstanding of what we did on March 14, Congressman.

Mr. LAFALCE. They have got access at, what, 13 percent?

Mr. SCHULTZ. As a matter of fact, yes, but they also have access through money market certificates and repos and other market instruments. And the cost of money to them is about in that area or a little higher.

Mr. LAFALCE. But there is no mandate to use that money that they pick up from the Fed for exclusively small business and agricultural purposes.

Mr. SCHULTZ. There has been some misunderstanding of the special credit restraint program, which was announced on March 14. We said to banks of all kinds: this program is not intended to restrain credit to small business or agriculture. We gave them guidelines of 6 to 9 percent for their loan growth for December to December. We said: if you are approaching the top of that guideline, restrain your loans to all others than small business and agriculture. If you hit the 9-percent ceiling, stop making loans to anybody but small business and agriculture. But you can make as many loans to small business and agriculture as you wish.

Thus, there is no restraint on loans to small business and agriculture. I think that this has been much misunderstood. But we have been very careful to clarify it at every opportunity.

It is our judgment that there is not a problem of credit availability in the larger banks. Furthermore, if they wish to do so, they can have special programs for small businessmen. It is not a question of whether they cannot do it; it is a question of whether they want to do it.

Mr. **LaFalce.** OK. Well, first of all, I want to applaud your new program because I think 100 percent assistance is needed and, if we get 10 percent, I want to applaud that 10 percent. Now I have done it.

Now, what are we going to do about the other assistance that is needed? In a great many communities the banks that you are dealing with in the urban centers of America, for example, we will be dealing with financial institutions that greatly exceed 100 million. And they would have a tough time finding, say, a commercial bank with assets less than 100 million. Is that not correct?

Mr. **Schultz.** Yes.

Mr. **LaFalce.** If you go to most of the urban centers of America, if you go to Buffalo and Niagara Falls, I think you are going to have a tough time finding any commercial institution of less than 100 million.

Mr. **Schultz.** I think in Buffalo or Niagara Falls they might be able to find them. In New York City that is a little more difficult.

Mr. **LaFalce.** I tell you, I do not know of any; I really do not. I would think the same thing is true in Cincinnati, Cleveland, you name it.

Mr. **Schultz.** In most major cities there are the smaller banks. But under any circumstances you are bringing up the question of whether this helps the small business in the urban areas.

Mr. **LaFalce.** Yes.

Mr. **Schultz.** And that we have tried to do through the credit restraint program in saying: Look, cut down your loans to everybody else except small business and agriculture. And let's just talk about small business because the urban areas are not going to be making agricultural loans.

Mr. **LaFalce.** OK.

Mr. **Schultz.** Now, the question of how much the banks have followed our instructions is one that is difficult to answer at this point in time.

Mr. **LaFalce.** The injunction not to cut down on your loans, even if adhered to, only goes to the availability problem. It does not go to the affordability problem.

Mr. **Schultz.** Congressman, that is a function of general monetary policy. And that is why we are trying to move through this period as fast as we can.

Mr. **LaFalce.** Well, I do not agree with you. You know, we have to have some microeconomic policy, and we have to have some special attention paid. Your request and exhortation of October 24 and your exhortation of March 14 called upon the financial institutions to tailor their programs.

Mr. **Schultz.** Congressman, if you are going to get into credit allocation, you are getting into a really serious problem. That is why——

Mr. **LaFalce.** You have gotten into it. The only question is how well are you going to get into it.

Mr. **Schultz.** We have gotten into it as a last resort because there is too much emphasis on general monetary policy. If you put the load on monetary policy, you have got problems——

Mr. **LaFalce.** Well, I agree with——

Mr. SCHULTZ. Problems to which there is no effective solution.

Mr. LAFALCE. I agree with you that we have to have an effective monetary policy and an effective fiscal policy and a whole slew of other things, too; no question about it. Regrettably, the Fed is bearing the brunt of inadequate attention to fiscal constraints and inadequate attention to those structural problems of our society that have contributed so largely to the underlying rate of inflation and to other problems in our society that have contributed to those factors contributing to inflation that are not underlying it but special.

But, if I had another witness in front of me who had responsibility for the other things, I would be talking about the other things. You have responsibility for monetary; so, that is all I want to talk about with you.

Mr. SCHULTZ. Well, with credit allocation, where do you stop, Congressman? You say you want to give money to small business. You say you want to give money to farmers. You say you want to give money to people who are in the inner city who want to do something to repair or rehabilitate their homes. You say you want to give some money to energy producers. You know, you can just go on and on—that is the problem with credit allocation.

Everybody in our society has some legitimate claim and I must tell you that the sooner we can do away with these credit controls the better the country is going to be. Controls are a terrible solution. I, for one, hope that we never again get into a situation where they are used.

Furthermore, I would certainly hope that we have learned enough this time not to ever let interest rates get to the levels that they are now, because they are very harmful at these levels. There is no question about that. But, when you get into this kind of a situation, the problem is finding a way out. As I told the chairman the other day: If we had been successful with the programs that were put in place after October, we would have much fewer bankruptcies than we are going to have now. And bankruptcies do not do anybody any good.

Mr. LAFALCE. Let me just give you an example of what you might do. I am just wondering what your reaction to this might be.

I have a for instance that a bank is doing the following: It is making a special effort to help small firms hold down the cash drain from interest on working capital loans, generally those made on 90-day notes at *x* percent above the prime. And they are usually rolled over for 90 days. Let us say the prime is 20 and they are giving the loan at 23. OK? That is not unusual.

They are telling their small business borrowers who have such loans: you pay 17 percent a month on a current basis and defer the additional interest cost—that would therefore be about 6 percent—until your rate flows below 17 percent. We, the financial institution, will maintain an escrow balance for that debt until the rate comes down to 17 percent.

What they are really doing, of course is adding the interest above 17 percent to the principal amount.

What is most helpful is that they apparently are not even charging interest on the escrow amount of the above-17-percent interest.

I think that is salutary.

Mr. SCHULTZ. I do, too.

Mr. **LaFalce.** I think that banks could responsibly do this, give tremendous assistance to the small business community. And I do not think that it would have detrimental effect upon the financial institution to speak of.

I have three questions.

First, does the Federal Reserve Board know how many banks there are that are presently using this kind of device to help small firms to maintain cash flow?

Mr. **Schultz.** No.

Mr. **LaFalce.** Second, assuming you think this is a good idea, which you have so stated, can we get the Federal Reserve Board, at the very least, to use its great moral influence with banks to get as many of the financial institutions as possible to do this kind of thing as quickly as possible?

Mr. **Schultz.** Well, we have already sent out letters. Another one will go out today as part of the package that I have talked to you about—a letter to the chief executive officers of all commercial banks in the United States. It will not only describe the program that I have outlined to you but will further explain the program already in place and emphasize that special consideration should be given to small business and agriculture.

Mr. **LaFalce.** OK. But——

Mr. **Schultz.** Banks are well aware of the kind of program that you have talked about.

Mr. **LaFalce.** I don't know. I don't know if that——

Mr. **Schultz.** The kind of program that you have talked about is nothing but smart banking. It should be done by a bank that is trying to take care of its small businesses.

Mr. **LaFalce.** If it should be done by the banking communities that are trying to take care of their small businesses, why, to my knowledge, to the knowledge of the small business community of America—we had approximately a dozen representatives of the small business community of America testify yesterday. They were aware of one bank in the United States of America that was doing something like this.

Mr. **Schultz.** They probably talked about Chase merely because that has been much in the papers.

They came in to see me. Frankly, I was aware that not much publicity had been given by various banks to their special programs. We are aware of 110 banks that do have special programs, who are doing something in that area. The small business representatives were not aware of this at all. So, there is a problem of——

Mr. **LaFalce.** Having special programs—every bank in America says they have a special program for small businesses. But saying you have got one, saying that we will sit down with you and we will talk with you and give special consideration, and that is our special program is one thing. But saying we've got a program for small businesses where we are going to put a certain amount of the interest into an escrow account and add it to the principal, that is a lot different. I think, if——

Mr. **Schultz.** You are certainly not suggesting that the Federal Reserve tell banks that they have to do that kind of thing; are you?

Mr. **LaFalce.** No, not yet. What I am suggesting is that the Federal Reserve, at the very least, could get a bit more specific as to what the financial institutions might do. It is another thing to say: go ye therefore and do good. It is another thing to say: go ye therefore and do good, and here are some of the ways that we think you can do good; we don't offer them as mandates. We don't say that these suggestions are exclusive, but we want to be sure you are aware of some banks that do it; and we think it's a good idea.

I think that the Federal Reserve, if they did that, could have a tremendous impact upon the practices of the banking community and in a very voluntary way.

Mr. SCHULTZ. Congressman, I do not think there is a banker in the United States that is so stupid that he is not aware of that kind of a technique.

Mr. LAFALCE. Being aware of it is OK. But, you know, having the moral influence of the Federal Reserve behind that idea is an awful lot stronger than just having some vague awareness of it on the part of a banker.

Mr. SCHULTZ. There are hundreds of techniques that can be used to give special considerations. You can vary rate, terms, and conditions of all different kinds. I am not sure——

Mr. LAFALCE. I am now asking the Federal Reserve to supply to the Small Business Oversight Subcommittee a list of the special techniques that are being used by the banking community of America to give special attention to the problems of the small business man.

Mr. SCHULTZ. All right, I think that we can. I have just been told that, in the office of the person who is assigned to attempt to collate the reports that we are just now getting in, there is now a stack about as high as this table. As soon as we begin that collation procedure, we will give you some information in that area.

Mr. LAFALCE. Do you have a ballpark idea how long that might take?

Mr. SCHULTZ. A week or 2.

Mr. LAFALCE. Fair enough.

At that time I will probably again ask you to take this material and urge the banking community. If not, as Chairman of the Small Business Oversight Subcommittee, I will encourage the banking community of America to do something like that and see if we cannot get the chairman of the full committee, the chairman of the Banking Committee both in the House and Senate side, et cetera, et cetera, et cetera. You know, the Chief Counsel for Advocacy of the SBA, et cetera.

I just think we have got to do more.

Mr. SCHULTZ. Hopefully, rates are going to be somewhat lower, too.

Mr. LAFALCE. I hope so. I think so.

Even if we return to an interest rate in December 1980 of 13 or 14 percent prime, that is still mind-boggling in comparison with our historical experience.

Mr. SCHULTZ. That is right.

I think, if you are just going to get rates down that low, you still have a problem. But I firmly believe that the monetary policy that we have announced of holding the growth of the aggregates within certain limits and, over time, year after year, slowly bringing the money supply growth down, in combination with a reasonable fiscal policy is going to have the effect of bringing inflation down very considerably and, hopefully, making interest rates considerably lower than that.

Mr. LAFALCE. Is there any specific incentive that the Fed has easily available to it to encourage banks to do something akin to what I am doing? Or would your new program today be that special type of incentive?

Mr. SCHULTZ. That is an incentive. It makes money available to them. It makes it available to them in an easy way and cheaper than a good many of them can get, the smaller banks in particular. The larger banks have more ways that they can get money.

Mr. LAFALCE. I had a dinner with Walt Wriston last night. He made a very interesting suggestion.

Mr. SCHULTZ. He always does.

Mr. LAFALCE. Yes. I thought this was pretty good, though. He said: you know, John, if the U.S. Congress could by resolution state that they concur with the monetary targets that have been established by the Federal Reserve Board—roughly what, 6 to 9 percent?

Mr. SCHULTZ. Well, that is on the credit side; and 3.5 to 6 on M1A and 4 to 6.5 on M1B; and 6 to 9 on M2.

Mr. LAFALCE. He said that he thought that this would be taken as such a signal in the financial community of America and the world that it might do more to help bring down the inflation than any other action Congress could take.

Mr. SCHULTZ. I think it would be extraordinarily helpful. I do not think there is any question that you are dealing in an atmosphere where psychology is more crucial than it has been certainly since the 1930's.

It was basically inflationary expectations that messed us up after October. Why didn't monetary policy work better than it did after the October 6 moves? After all, those were regarded as very, very stringent kinds of policies. They resulted in interest rates which were regarded as historically extraordinarily high in this country and were, I guess, the highest since, if I read the history books correctly, Van Buren's time in 1839.

Now, why didn't it work? Why didn't these actions have the expected restraining effect? Well, you know, they did in October. In October the economy looked like it was slowing. November it looked like it was slowing, and in early December too. All of a sudden, the week before Christmas, boom; people went out and spent like crazy.

The same thing occurred in January and February. The economy surged. People, instead of building up their savings at these high interest rates, turned right around and spent and cut their savings.

Why? Well, they did it because they thought inflation was going to continue. They thought that policies were going to be such that, even though the Federal Reserve was going in one way, the Congress and administration were going to move the other way because of things somewhat beyond their control: Iran, Afghanistan, OPEC. All of these things added to these inflationary expectations. People said: Inflation is going to be there; if I want something, it's going to cost me more later on; let me go out and buy it now.

I think that we are doing something about inflationary expectations right now. This economy appears to be weakening pretty rapidly.

That clearly is a reflection of people beginning to pull in their horns, beginning to slow down on their spending and increase their savings and tighten the belt some.

But I think that a resolution of that kind would be extraordinarily helpful. I do not think that there is any question that particularly for the financial markets, the currency markets, in terms of supporting the dollar and in many other ways that you are talking about something which will be very helpful.

Developments in those markets have immediate effects upon people. We discovered that devaluing our currency increases prices to people throughout the country. What the currency does is important to the little old lady in tennis shoes in Nebraska, and is not just some arcane, esoteric kind of thing that occurs in the money centers of the world.

So, the kind of thing you are talking about—even if it's just a resolution—shows support. It shows that we are all moving in the same direction. Would it be helpful? Indeed it would.

Mr. **LaFalce**. I do not want to hold out any false hopes to you and think you are going to get that resolution.

Mr. **Schultz**. Well, I am trying not to hold out false hopes to you, too, on the monetary policy side.

Congressman, it is clear that we have got some tough months ahead of us. The fewer tough months we have, the better off we are all going to be. We really are very much aware of how tough it is for some small businesses out there. I used to be in the venture capital business. I know a little something about small business. I know that they rely heavily on bank debt. I know how tough it is for them to obtain the kind of money they need.

I know very well that some of them are not making it and some are not going to make it. I, for one, would like to see us get through as quickly as we can so that we have the fewest possible number who do not make it.

Mr. **LaFalce**. I think that, in order to get through it with the fewest possible numbers, we are going to need more consideration from the Federal Reserve about the special plight of the small business community than we have seen up to now and than we have seen even as of today.

I think we are going to need at the very least some of the moral suasion from the Federal Reserve that I have called for today. I encourage you to consider that even more deeply in the future than you have in the past.

Let me ask you a few more questions.

I am constantly hearing the Fed kicked around—you are, too—as the causal factor of the high interest rates: It's the Fed's monetary policy that is causing high interest rates. That is how the argument goes. And it is the high interest rates which are causing inflation or, at the very least, exacerbating inflation and also causing the economic dislocations in society, the closures of plants, businesses, et cetera.

The counterargument that I have heard from the Fed is: Wait a minute, our monetary policy doesn't cause high interest rates; it's inflation. Interest rates trail inflation primarily. We are simply attempting to cope with inflation and thereby bring down the interest rates.

Would you care to comment upon that?

Mr. **Schultz.** Monetary policy works on the economy through interest rates. Now, it depends on what kind of monetary policy you are going to have, or at least up to a point it depends on the kind of monetary policy you are going to have.

There was a time when, if you eased monetary policy and you injected more money and credit into the economy, interest rates would go down. I think there is a real question at this point in time whether that continues to be the case. It is clear, I think, that money is like any other commodity. People who loan money are going to demand, over time, a real rate of return; which means that they are going to want something over the inflation rate.

So, you cannot, for any great period of time, have an interest rate which is below the inflation rate. As a general statement, interest rates will follow the inflation rate in the economy, although they can vary up and down to some degree depending upon monetary policy.

But I think at this point in time we are caught in a catch-22 situation in which high interest rates are going to be a fact of life in this country whether you have a firm monetary policy or an easy monetary policy. I am very much afraid—and I think there is considerable evidence to show—that, if the Federal Reserve today were to inject money into the economy in large amounts, rather than having a sharp drop in interest rates, you would have the wide perception that the Federal Reserve had merely given up on inflation, that inflation was going to get a lot worse, and lenders, rather than lowering interest rates, would have a tendency to increase interest rates.

So, I think that there is no way to get out of the high interest rate situation that we are in without some weakening in the economy. That is why we are led to the statement that I gave to you originally.

I think that a recession is something that has to happen in this country. We want to move through it as quickly as we can, and we want to make it as least painful as possible.

So, to try to quickly answer your question, basically interest rates are going to be a function of inflation.

Mr. **LaFalce.** The——

Mr. **Schultz.** Let me just make one more comment on that. You started out by saying the Fed had been much criticized. I really think that that is a function and responsibility of the Federal Reserve. The Congress, in its wisdom, created an organization with the ability to be responsive quickly, to act in an independent way.

I think that there is every evidence that an organization of that kind is necessary in this country. If you have the kind of organization that can be flexible, can be responsive, it is going to be out front and it is going to catch hell.

I think that that is exactly the situation we are in. I would expect it to get worse. But it seems to me that that is one of our basic responsibilities, to take the action that needs to be taken.

Mr. **LaFalce.** I wanted to read to you from the testimony given yesterday by the National Federation of Independent Business.

Mr. **Schultz.** The National Federation of Independent Business or Small Business?

Mr. **LaFalce.** Independent Business.

It is basically the largest organization——

Mr. SCHULTZ. That is McDevitt?

Mr. LAFALCE. Precisely.

Mr. SCHULTZ. Right. OK. I had breakfast with him last week trying to go over some of these things.

Mr. LAFALCE. This is their testimony:

> According to a study conducted by William L. Silber and Murray E. Polakoff, commercial banks do ration small businesses out of their commercial loan portfolios during periods of restrictive monetary policy. Using data collected by the Federal Reserve system in 1955 and 1957, which is the only set of data giving a breakdown of commercial and industrial loans by size of borrower, Silber and Polakoff demonstrated that, during tight money periods, banks wished to favor large business by raising the portion of funds available for large business loans while reducing the amounts earmarked for small business loans.
>
> Given these different lending propensities during these periods, they were able to show that the desire to ratio small business loans actually resulted in the rationing of these loans.

There are two points that deeply disturb me. One, assuming the validity of the Silber and Polakoff study—and I say assuming its validity—I am disturbed by the adverse rationing of loans, adverse to small business.

No. 2, I am also disturbed that the only data that we have is data that was collected in 1955 and 1957 by the reserve system. We lack present data.

Do you care to make any comments on that?

Mr. SCHULTZ. Yes. You know, the problem is that collecting data produces an enormous reporting burden. It gets to be much bigger than you can possibly imagine. And we require so much reporting from these banks. We are requiring an awful lot more right now.

Reporting does involve serious problems. It is not just an easy kind of a thing where you say: why don't you get the data. There is a real reporting burden problem, which we try to add to as little as possible. And we ask them for all kinds of things as it is. So, it does get to be a difficult problem.

As to the first part, we must recognize that a banker has several basic responsibilities. He has a responsibility as an intermediary in our economic system, where he takes in money from those who have it and gives it out to those who want it. A good banker, I think, does what he can to do that kind of thing as well as he possibly can because it is good for his community. A good banker ordinarily will see that what is good for his community is good for his bank.

So, he will be trying to take care of good small businesses because he knows that, like acorns, they grow. If he has taken care of a small businesses when the business really needs it, then they are going to stick with him.

On the other side, however, he has a responsibility for the safety and soundness of his organization. That responsibility is to those who have money in his organization.

So, he has to look at where his risk is in terms of his loans. Unfortunately, it is true that small businesses are riskier than big businesses. It is partly because they have less capital. But, this gets to be a circular thing. Small businesses are undercapitalized. They need more capital. Where can they go to get the capital? Banks. So, they are caught in a very difficult kind of situation.

It is my judgment that bankers are today doing a better job in that particular area than the figures that you quoted from the middle fifties. Remember that you are talking about much lower interest rates in the 1950's. And the level of interest rates as a burden on small business was not as crucial a factor as it is today.

We were still in a period where we thought there was going to be that post-World War II depression like the one after World War I. Bankers were still looking pretty heavily at risk, as they still do. But I think there is less of that today.

My judgment is that, if they did the same study, it would indicate that bankers are doing a little better job taking care of their small business customers than they did then. They are not cutting them out to the same degree.

I have a note here that we are presently cooperating with SBA and with other agencies on an interagency task force to study whether further loan data collection by business size would be desirable. The study is being coordinated by Paul Horvitz, who is an outside economic consultant.

So, maybe we will have more data for you sometime in the not-too-distant future.

Mr. LaFalce. OK. Mr. Schultz, we could continue this dialog forever——

Mr. Schultz. We are in a tough period, Congressman. There is not any question about it.

Mr. LaFalce. I find it very interesting——

Mr. Schultz. I would hope a month from now things would be a little easier on some of the people that we are both concerned about.

Mr. LaFalce. I agree with you in that hope.

Thank you very, very much. I appreciate your testimony this morning.

I would now like to call to the witness table both Mr. Daniel P. Henson and Mr. Howard Hjort of the U.S. Department of Agriculture.

First, we will have a 2-minute recess.

[Recess taken.]

Mr. LaFalce. The subcommittee will reconvene.

We will first hear from Mr. Daniel Henson.

TESTIMONY OF DANIEL P. HENSON III, DIRECTOR, MINORITY BUSINESS DEVELOPMENT AGENCY; ACCOMPANIED BY ABDUL SHAIKH, DEPUTY ASSOCIATE DIRECTOR FOR POLICY; AND BARRY ROBINSON, CHIEF COUNSEL

Mr. Henson. Thank you, Mr. Chairman.

Let me start out by saying that I welcome this opportunity to appear before this committee today and to represent the Minority Business Development Agency and the Department of Commerce with regard to the impact of inflation upon minority businesses.

Let me introduce, first of all, Dr. Abdul Shaikh, who is Deputy Associate Director for Policy of MBDA, who is to my immediate right; and Barry Robinson, who is chief counsel for MBDA.

The Office of Minority Business Enterprise, our predecessor agency, was established within the Department of Commerce in 1969 pursuant to Executive Order 11458. Its authority was expanded in 1971 by Executive Order 11625, and it has since been reorganized. Today, as the Minority Business Development Agency, we continue to focus upon the needs and problems of the minority business community. Specifically, Executive Order 11625 authorizes this Agency to implement Federal policy, provide technical and management assistance to minority-owned businesses, assist in demonstration projects, and to coordinate Federal efforts to facilitate minority enterprise development.

At the current time, the Minority Business Development Agency has 4 major divisions within its main office and 6 regional and 23 district offices to serve the needs of the minority business community throughout the country.

Our program elements are currently being reorganized to better serve the present and future needs of the minority business community. The Office of Policy and Market Development develops policies to deal with the issues and problems facing minority businesses; coordinates Federal procurement and financial assistance goals; advocates minority interests before regulatory and rulemaking bodies; assists in expanding State and local business efforts; and fosters increased private sector development efforts.

The Office of Planning, Budget, and Evaluation develops annual and long-range planning and programing processes. The Office of Enterprise Development provides client firms with managerial and technical assistance by contracting with private, nonprofit management, and technical assistance organizations in over 180 locations.

Finally, the Office of Research and Information assimilates and gathers data on minority businesses and provides information to minority businesses, Federal agencies, and suppliers, buyers, and investors who deal with minority firms.

In accordance with the President's commitment to accelerate the development of minority business enterprises, the Department of Commerce has recently submitted legislation to the Congress to give MBDA statutory authority which will reinforce the current minority business enterprise program.

Before I discuss the impact of inflation on minority businesses, allow me to point out the fact that minority businesses are for the most part small businesses. There are, however, some very unique characteristics which tend to magnify and exacerbate the minority business situation. These characteristics are:

Concentration of businesses in high density, low individual income urban areas;

Heavy dependence on local minority patronage;

Heavy reliance on debt capital for financing operations which results in higher than industry norm debt to equity ratios; and

Overconcentration in retail and selected services.

Based on these characteristics, we may conclude that although economic fluctuations adversely affect all businesses, these effects are detrimental to small business community and most probably even more detrimental to the minority business community. More explicitly, if demand is down in the general economy, it is lower in the small business area, and lowest in the minority business community. Therefore, any detrimental impact experienced by the business sector on the economy because of adverse economic conditions places very severe hardships upon the minority business sector.

Because minority business development is MBDA's basic mission and responsibility, I believe that it is noteworthy that this committee has asked us to testify about the problems facing the minority business community. In doing so, I will first proceed to delineate our perception of the general problem. I will then address the specific impact of inflation upon minority business. Finally, I will enumerate those actions that we are taking, and our recommendations for future action.

The impact of current inflation upon the minority business community is a topic which has not been exhaustively researched. This is due to both a lack of data and dissension as to whether minority businesses can be distinguished in fact from small businesses. Nevertheless, we are aware of the widespread impact of inflation on businesses. Inflation coupled with the measures taken to combat inflation tend to increase interest rates, reduce consumer and industrial demand, and increase unemployment.

To be more specific, these factors impact minority businesses by increasing the cost of operating, reducing consumer demand, and reducing the availability of credit. In short, they operate to reduce or eliminate profitability and to curtail business longevity.

Minority businesses are generally more reliant than majority businesses upon debt in their overall capital structure. The center for studies in business, economics, and human resources of the College of Business at the University of Texas at San Antonio, in a recent study performed under contract to MBDA, substantiated the hypothesis that minority business enterprises have very high debt-equity ratios. The researchers looked at a sampling of 6,000 firms from Dun and Bradstreet's data base.

They classified the 6,000 firms into the following categories: Minority/MBDA assisted firms, minority/non-MBDA assisted firms, and a control group of small majority businesses exhibiting similar size and industrial characteristics to the minority firms. The researchers have attributed the high debt to equity ratio of minority business enterprises to the low level of savings in the minority community and to the high risk perception of investors toward minority businesses. A combination of perceived risk and the high debt to equity ratio increases the cost of doing business and impedes cash flow and limits the ability of businesses to generate excess internal capital for investment or expansion purposes. Current rises in interest rates exacerbate these problems.

Additionally, because of the poor equity situation and the restrictions upon entry into the industrial sector, minority businesses are generally concentrated in highly competitive areas where they have very little influence on determining prices.

The 1977 census of black-owned businesses depicted a 39 percent concentration in retail businesses, and a 22 percent concentration in professional and selected services. We can safely assume that other minority-owned businesses have a similar concentration in these areas.

I will attempt to show the specific impact of inflation upon minority businesses. Increased unemployment results in reduced individual income, thus reducing the general consumer demand. The minority community has traditionally experienced an unemployment rate higher than that of the general populace and has usually borne the brunt of unemployment increases.

Because of their location, minority businesses are dependent, for the most part, upon minority patronage. Consequently, they will suffer most from the decline in demand attributed to higher unemployment.

Furthermore, excessive inflation reduces the real purchasing power of consumers thereby forcing a tradeoff between price and the other shipping selection variables of convenience, packaging, and brand names in such a way that price dominates. Minority businesses tend to suffer more from reduced consumer and industrial demand. Higher interest rates increase the cost of capital.

Since minority businesses are heavily dependent upon debt financing, high interest rates impact most significantly upon them. A tight money supply only exacerbates the problem. Studies by Professors Silber and Polakoff of New York University, Dr. Ou, and Dr. Berney of the SBA and others show that, in times of tight money, the following consequences occur:

Commercial banks ration credit to small businesses;

Commercial banks are more selective in making loans;

Small and minority businesses are priced out of and denied access to the credit market; and

Large businesses crowd out small and minority businesses from the credit market.

Since minority businesses are very dependent upon credit financing, the effect is that credit becomes more expensive, or is not available. Moveover, if credit is obtained, it impedes cash flow and increases the costs of doing business.

The National Automobile Dealers Association, in an April 3, 1980 testimony before the Senate Committee on Small Business, stated that as a direct result of high interest rates on inventories, approximately 10 percent of the Nation's new auto and truck dealer franchises will fail this year. Our records indicate that there are currently 311 minority-owned new auto and truck dealers, of which 51 are in the top 100 black and Latino firms, as determined by gross sales. Assuming only 10 percent of these dealerships were to fail, this would mean a loss of 31 significant businesses and 900 jobs. Unfortunately, we expect the failure rate among minority auto dealers to far exceed 10 percent.

Another sector adversely affected by inflation is the minority banking sector. The safety and soundness of smaller and newer minority-owned banks are threatened. For example, in the 1920's, after a decade of unprecedented growth, the stock market crash and the ensuing depression forced the closing of all of the 13 black banks in existence at that time. Although we do not anticipate a repeat of the economic conditions of the 1920's, we notice that today's anti-inflationary cash management procedures are causing the withdrawal of sizable deposits from socially responsible individuals and corporations.

The impact of inflation is one of significant concern to the survival of minority business community. However, MBDA realizes that the administration cannot afford to allow inflation to continue unchecked, and we are prepared as a community to make sacrifices and to encourage sacrifice from the minority business sector.

In response to the severity of the inflation problem, MBDA is utilizing its research staff to continuously monitor the effects of current economic conditions. For example, in April a sample survey was conducted by MBDA of its funded business development organizations—BDO's—selected MESBICS and the Small Business Administration to ascertain the impact of higher interest rates on minority firms. The period selected for the survey compared the impact between the last quarter of 1978 and the last quarter of 1979. The survey reveals that:

The MBDA business development organizations reported that there has been a generally steady flow in the number of old and new minority clients seeking financial assistance.

The number of financial applications from the BDO's on behalf of minority clients to financial institutions has declined. Although the demand remains strong, the availability of funds is limited and processing time has increased. Conventional financial institutions are now in a position to apply very stringent credit evaluation techniques which will unfairly prohibit minority competition for credit dollars.

Conventional financial sources are more or less inaccessible to minority business enterprises especially in States with usury laws.

The basic result of this squeeze is that credit financing for minority business enterprises is generally unavailable and, if available, is far too costly.

The impact of the credit squeeze is that a disproportionate amount of marginal MBE's will be forced out of business. Stronger minority business enterprises will not only be placed in a precarious financial position, but may also be forced out if the tight money conditions prevail for any protracted length of time.

The survey of MESBICS indicated that they have received a higher number of requests from minority business enterprises but are only able to assist a very limited number of firms.

Delinquency rates for minority business enterprises have increased.

Total SBA guaranteed loans decreased slightly from 1,192 to 1,145. The delinquency rates increased from 9.9 to 10.8 during the same quarters of the survey period.

Most distressing, SBA has pending 672 approved loans to minority business enterprises for $47.3 million, which funds are not available for disbursement.

MBDA provides a range of management and technical assistance services designed to aid our constituents. Our program areas, especially the Office of Enterprise Development, are investigating alternative means of providing technical assistance which will improve business relations. The Office of Policy and Market Development is exploring avenues to facilitate access to capital for minority firms. We are monitoring, working with, and fostering activities within other Government agencies which will maintain, increase, and diversify minority procurements. Through the National Minority Purchasing Council, we are working with the major corporations to increase their purchases and services to minority suppliers.

The Federal Reserve's and the administration's anti-inflation policy is primarily one of reducing credit. As acknowledged previously, this has serious repercussions on the minority business community. The Federal Reserve Board has recognized this problem and has stated its intent to address the issue. It is too early, however, to determine its effectiveness.

We are committed as an agency toward weatherproofing the minority business community against extreme economic fluctuations to the extent that our resources allow. The survival of the minority business sector is important. It provides a source of employment, meets a need, and delivers a product. It allows for a certain amount of economic independence for minorities and contributes to the overall economic development of the country.

Between 1972 and 1977, black-owned businesses experienced a 51-percent increase in gross receipts, a 21-percent increase in the number of firms, and a 6-percent increase in the number of persons working for firms with paid employees. This is certainly not explosive growth, but it indicates a shift in the minority community from exporting cheap labor to exporting competitive products.

Before concluding, allow me to reiterate the effects of inflation on minority business enterprises:

Increased interest rates resulting in a high cost of doing business;

Reduced consumer demand and severely restricted cash flow;

Unavailable credit due to capital market imperfections;

Bottlenecks in delivery and unavailability of inventory.

All of the above fortell a significant upsurge in the failure rate of minority businesses. Furthermore, uncertainty of current economic conditions has added to the complexity of problems faced by minority businesses.

It is difficult to impress sufficiently upon you the seriousness of the current situation and the severity of the potential impact. Suffice it to say that we expect to experience a dramatic upsurge in minority business failures over the ensuing months.

Thank you for your attention. I will be glad to answer any questions you have.

Mr. LaFalce. Thank you. We will defer questioning you until we have heard from the Department of Agriculture. The only thing I want to say is that I think I agree with just about every single word of your testimony.

We have seen the problems in small business. We have had a number of individuals testify. When it comes to minority business, the problems of the small business community are simply multiplied two, three, four times. We need special policies for small business in general. But there is that much greater need for minority business in particular, it seems to me.

I do not think we can do that through the Federal Reserve Board. I do not think the Federal Reserve can tailor their department to that. But the administration through its agencies might be able to devise special mechanisms for helping minority business through this special time. Maybe it would be through programs of the SBA or other programs, but it is something to be explored.

We will now hear from Mr. Howard Hjort.

TESTIMONY OF HOWARD W. HJORT, DIRECTOR OF ECONOMICS, POLICY ANALYSIS AND BUDGET, U.S. DEPARTMENT OF AGRICULTURE

Mr. Hjort. Thank you, Mr. Chairman.

I am pleased to be here today to discuss the impact of inflation on the small business community and talk about the Department of

Agriculture's efforts to alleviate inflationary pressures and also those to help offset the adverse consequences of inflation on small business.

I do have a rather lengthy statement. Mr. Chairman, with your permission, I would like to have it inserted and then proceed to summarize it.

Mr. LaFalce. It will be inserted into the record in its entirety. Please summarize.

[Mr. Hjort's prepared statement follows:]

Prepared Statement of Howard W. Hjort, Director of Economics, Policy Analysis and Budget, Department of Agriculture

Mr. Chairman and members of the committee, I am pleased to appear today to discuss the impact of inflation on the small business community, the Department of Agriculture's efforts to alleviate inflationary pressures and to help offset the adverse consequences of inflation on small businesses.

While USDA's programs serve those who live throughout the United States and in many foreign countries, most of our assistance goes to those who live and work in rural America, the home of a disproportionate share of the nation's small businesses. And although our programs provide assistance to those whose income level ranges from very low to quite high, most of our efforts are aimed at those with low incomes or with limited resources. Almost all of the nation's farmers meet the definition of a small business, and most of them conduct their business with firms in our small communities that meet the definition of a small business.

USDA is a major credit agency, loaning $25 to $26 billion this fiscal year for a variety of purposes:

Around $10 billion to farmers on the crops they produced last year, for the continuation of farm storage facilities for farm operating capital and to purchase a farm;

About $2.8 billion is available to finance the exportation of food and other farm products, including about $1.0 billion for food sold to low income countries under relatively favorable repayment terms;

Around $4.5 billion is available for rural housing loans, with most of these funds reserved for low income borrowers;

Nearly $6.5 billion is available for rural electric, telephone and communication loans, to provide such service to small business in rural areas;

About $1.1 billion is available for business and industrial loans, and nearly $0.9 billion for community facilities and water and waste disposal systems.

About $14 billion will be expended this year on the domestic food assistance programs, with $9.5 to $10 billion for the food stamp program and the special supplemental food program for women, infants and children.

In addition, we will spend about $2.75 billion in managing and developing the forest resources of the nation, and to encourage farmers and communities to protect and develop the nation's soil and water resources. About $1 billion will be spent on research and education, and additional funds will be spent to help control pests and diseases to supplement returns to farmers, for marketing programs, food safety and quality programs, rural development grants and contracts and management and administration.

Small businesses are affected by most of our programs. Farmers are affected by many of our programs, and with agriculture the largest industry in our economy, it is vital that they be able to produce, sell and move their output where it is needed. Farmers' financial well-being reverberates throughout the rural and domestic economy. The industries that are based upon our nation's agriculture are dependent on the ability of our farmers to produce. But small businesses are also affected through the other programs of the Department.

INFLATION AND RURAL AREAS

A major consequence of the changing structure of rural areas—principally a diversification of income sources and employment opportunities—is that they have become more like urban ones. This means that many of the effects of inflation and of policies to mitigate inflation will be felt similarly in urban and rural areas. For example, any general increase in unemployment is likely to be shared by both. In fact, in the severe recession of 1975–76, peak unemployment rates for rural areas exceeded those for urban areas. Since unemployment rates for rural areas are biased downward, this understates the real impact of the recession on rural areas.

The most significant change in rural America in the 1970's is the resurgence of population growth after decades of decline. There is no evidence to suggest that several years of high inflation have lessened this trend. Most of the population growth results from migration—a significant influx of formerly urban residents into rural areas. This growth is reinforcing the "urban" character of rural society, since many of these former urban residents bring with them higher expectations about the scope and quality of public facilities and services than longtime rural residents hold. Combined with rapidly changing costs for all public programs and a growing reluctance to pay higher taxes to support increased public expenditures, the changing population and values of rural people put serious stress on local institutions and decision-making. In the short-run, this is likely to be exacerbated by the high interest rates and the coming recession.

Inflation generally hurts most: those whose incomes are low and either fixed or not rising as fast as inflation, and business operators not in a position to pass higher costs on to customers through higher prices.

Rural America is hit hard on both accounts. Rural areas and small towns have a disproportionate share of people with low incomes or living on relatively-fixed incomes. For various reasons, these same people are less likely to be participating in programs such as food stamps, rental assistance and other programs which could help alleviate the impacts of inflation. Moreover, one of the major businesses in rural areas—farming—is one where costs of production tend to rise with inflation while prices received do not—they are largely determined by short-run, supply/demand conditions. The industries that supply the machinery, chemicals, fuels and other inputs to farms tend to be highly concentrated and able to pass their higher costs on to farmers.

Thus, inflation generally tends to increase the cost-price squeeze on farm businesses. This situation gets translated into increased demand for credit and thus a tightened liquidity situation in rural credit institutions generally.

The increased demand for credit funds for farming reduces funds available from banks for non-farm businesses and increases demands for increased funding of public credit programs such as FmHA, Commodity Credit Corporation and the Small Business Administration. These conditions also tend to be exacerbated by the higher interest rates which usually accompany inflation.

A unique impact of inflation and high interest rates on agriculture is that in such periods, life insurance companies—traditionally an important supplier of farm real estate loans—lose their funds to policy loans and high return urban ventures and have to withdraw from the farm credit market. This leaves farmers with Federal Land Banks and individuals—usually land sellers—as the only significant alternative sources of long-term equity.

One of the other major negative impacts of inflation is that it tends to shift the flow of capital from productive uses—which would be counter-inflationary—to inflation shelters; especially assets and scarce goods that tend to increase in value with inflation. Again, rural areas tend to be impacted disproportionately because land—a favorite hedge against inflation—is such an important part of the asset base. The dramatic increase in land values—another 16 percent last year—has contributed to large increases in farm real estate debt, absorbed large amounts of scarce capital that could have gone to more productive uses, increased the underlying costs of producing farm products and greatly increased the difficulty for new entrants to get started in farming. The ones hurt most by this difficulty are small farm businesses, including minorities.

In the past, rural areas were spared much of the burden of sharply higher interest rates which prevailed in the big money markets during periods of high inflation rates. Rural banks obtained funds from low-interest paying time and demand deposits and thus, could lend at low rates, somewhat isolated from pressures faced by urban banks and central money markets.

With the advent of money market certificates and other devices for assuring small savers competitive returns on their savings, rural banks—during the past year—have suddenly found themselves having to compete for funds in the same markets as large urban banks. This new experience for rural bankers—themselves small businessmen—means higher interest rates for farmers and small businesses in rural areas.

Inflation also impacts on the farm and rural economy through the export markets. Farm product prices are not rising with inflation or the depreciation in the value of the dollar. This has reduced the real cost of American farm products abroad and likely has contributed to growth in exports of our farm products. These exports are expected to reach a record $37 billion this year and are a major source of foreign exchange for financing our large petroleum imports. However, the global markets for our farm products are fundamentally strong, and our long-term interests are better served by a stable world economy not plagued with high inflation rates.

The impact of sustained inflation on the structure of U.S. agriculture has important implications. Perhaps the two greatest long-run impacts are the increased concentration of farm assets and the increased separation of asset ownership from the actual farm operator.

During a period of high inflation, investors seek to trade dollars for hard assets. In the past, farmland has been a successful hedge against inflation. Over the past 8 years, the price of farm real estate has risen substantially relative to the general price level. This increase in equity is monetized by using it as collateral for loans. Farmers with large equity positions find it relatively easy to acquire funds for enlarging existing farms.

Established farmers have numerous advantages in bidding for additional land. They usually have large equity positions and they are in a position to subsidize the new tracts of land until they begin to show a positive cash flow. In addition, the borrower would benefit from substantial capital appreciation. If unchecked, this process could eventually result in the disappearance of "small" family farms. One indication of this possibility is that in 1978, 68 percent of all farm tracts sold were purchased by existing farmers.

Inflation is having a mixed effect on use and management of water resources and on related impacts of agricultural structure. In the areas where water prices are low and stable such as most Federal surface irrigation projects, farmers are able to handle increasing costs for other inputs with fewer adverse affects. In areas of pump irrigation—where soaring energy prices are driving costs up even faster than average—there are potentially serious consequences. We would expect that in pump areas, several things may be happening:

More attention is being given to water conservation and improved water management. Crop yields could decline in a few isolated cases.

Farmers may shift to crops that use less water in order to cut pumping costs.

If the trend continues, more pump-irrigated land would come up for sale and land prices in pump areas could decline.

Higher interest rates are slowing demand for housing and other construction. In turn, the lumber industry is facing reduced demand for lumber. Rural communities heavily dependent on the forest industry will experience higher unemployment rates.

THE CURRENT SITUATION

The overall situation of those served by the Department of Agriculture is not unlike that any other segment of the economy is experiencing. There are, however, several factors which are affecting the farm economy and, in turn, the economy in rural America.

Most producers entered 1980 in relatively good economic condition. In 1979, cash receipts increased rapidly because strong domestic and foreign demand kept farm product prices high despite record production and increased marketings. Cash receipts outpaced rapidly rising production costs in 1979.

However, production expenses in 1980 will increase much more rapidly than cash receipts, placing many producers in a severe cost-price squeeze.

Several factors are principally responsible for the current situation.

Inflation is the principal reason for the rapid escalation in the costs of producing food and other farm products. In recent years, farmers have become increasingly dependent on purchased inputs and borrowed capital. This year's price increases for production items will push the cost of farming up sharply, following a 16-percent increase in costs last year. The overall increase in 1980, however, masks the effects of some exceptionally large price increases for some inputs that have a large direct and immediate impact on farmers' cash costs, particularly now at the beginning of the crop production season.

Prices for fuel used in farm production likely will rise 50 percent or more in 1980. Fertilizer prices are forecast to increase about a fourth. Short-term interest rates are expected to average about a third higher than 1979.

Because fuel and fertilizer costs are a large part of the variable costs of farming, the farm sector is particularly vulnerable to higher prices. For example, in

1980, fuel and fertilizer will make up about 47 percent of the variable costs for producing corn, 43 percent for wheat and 30 percent for rice. In addition, higher energy prices are the major factor raising the cost of crop drying and irrigation water pumping.

Per-acre production costs (excluding land costs) increased an average of 17 percent in 1979 for 10 major U.S. crops.

Considering the importance of fuels and fertilizers and the effects short-term interest rates can have on total costs of production (excluding land charges) can be expected to increase about 20 percent in 1980 for most crops—well above the overall rate of inflation. Cost increases will be higher for crops such as rice that use large amounts of energy for pumping irrigation water and grain drying.

The impact of inflation on cost of production will be greater for crops than livestock. Prices received by farmers for feed crops and livestock are expected to increase little in 1980, so the cost of feed and livestock purchased will increase less than the overall rate of inflation. Except for marketing and processing cost, these feed and livestock expenditures represent transfers within the agricultural sector. Increases in farm wage rates and seed prices are also lagging behind the inflation rate.

Steps to curb inflation through tight monetary policies, however, will make credit more expensive and harder to get.

Historically, farmers have been relatively well served by their sources of farm loans—probably better than any other segment of the economy. Loans have been available from a number of sources at relatively reasonable rates and in adequate supply. Traditional farm lenders such as commercial banks, Production Credit Associations (PCA), Federal Land Banks (FLB), life insurance companies, Farmers Home Administration, and individuals and others have provided farmers with loans in many instances when non-farm loans were not available in adequate amounts.

Farm loans, too, have generally stayed a percentage point or so below the non-farm loan rates; that is, until recently as rural banks have lost their advantage of monetary isolation and are having to pay their depositors the higher earning's rates to attract funds. As I mentioned before, PCA's and FLB's are having to pay central money market rates for funds and although their newly-acquired funds are mixed with some already on hand, their average interest rates will continue to rise. Farmers Home Administration loan rates have also become pegged more closely to Treasury rates and are sharply higher. So are Commodity Credit Corporation rates. Life insurance companies are practically making no new farm loans while individuals and others are still supplying financing but at rates similar to bank rates.

The recent rise in the cost of funds has not been confined to agricultural commercial banks. Indeed, the cost of funds to other agriculturally-related financial institutions—such as Production Credit Associations and Federal Land Banks—has also risen sharply. This rise probably will affect interest rates charged by PCA's more than those of FLB's since PCA's have a greater proportion of short-term debt which must be "rolled over" frequently; therefore, they are more sensitive to changes in interest rates.

While inflation increases the prices that farmers must pay for production inputs, it has little influence on agricultural commodity prices which are largely determined by short-run, supply/demand conditions.

This year, a combination of unprecedented events has severely affected crop prices:

> Early in the crop year, the upper middle west region of the country was hit by a port strike at Duluth Superior, thereby backing up marketings throughout the system.
>
> Two railroad lines also serving the upper midwest region went bankrupt aggravating the congested conditions and further depressing prices.
>
> The livestock sector, in a state of imbalance as a result of two years' rapid over-production, also saw prices slip.
>
> The suspension of sales to the Soviet Union has also affected grain prices even though these other factors are of greater importance.

These factors have combined to create a bleak spring scenario for the agricultural sector. Actions by the government to offset the impacts associated with the suspension of sales to the USSR are providing cash to producers.

The Commodity Credit Corporation now has bought about 156 million bushels of wheat and 50 million bushels of corn directly from country points to isolate from the market the quantities of wheat and some of the corn affected by the sales restrictions. While the wheat purchases have been completed—at least for now—additional corn purchases will be made.

The farmer-owned reserve program is also isolating supplies. Since the suspension was invoked more than 34 million bushels of wheat and 197 million bushels of corn have been entered by producers. Under a special program, corn producers who did not participate in the 1979 programs may place a total of as much as 295 million bushels in reserve on a first-come, first-served basis, as long as they do so by May 15.

Under the Emergency Agriculture Act of 1980, target prices for wheat and feed grains were increased, giving producers higher income protection.

THE ANTI-INFLATION PROGRAM

For all the reasons I have just reviewed, the Department of Agriculture and the citizens it serves have an important stake in our nation's success in the fight against inflation. The President's anti-inflation program includes a number of carefully balanced steps designed to achieve this end. His five-part program involves increased discipline in the Federal budget, restraints on credit, wage and price actions, greater economic conservation measures and changes in the structure of our economy to encourage productivity, savings, research and development.

The two steps which most directly affect the Department of Agriculture and its programs are the reductions in the Federal budget in 1981 and the implementation of policies to restrain credit, including Federally provided or guaranteed credit. For the further information of the committee, I have attached to this statement a briefing paper which provides an overview of the USDA budget reduction and actions to restrain credit. However, there are a number of points which need to be made regarding this package.

The program proposed for 1981 is a carefully balanced package involving about 97 percent of the January estimates for USDA programs and credit activities. Actions to mitigate the impact of the grain suspension on farmers are not affected by the budget revisions.

We remain committed to provide extra help to farmers to secure operating credit. To do so, the Department is implementing the extended economic emergency loan program and has made $1 billion available immediately under this program. Since the new law went into effect on April 1, more than $300 million in economic emergency loans have been approved. You have discussed the recent actions of the Federal Reserve and I'm sure, reviewed their policy with respect to favorable treatment for farmers and small businesses. The Farm Credit System has experienced a sharp increase in loans made and with their own source of funds, are providing a larger share of the farm and rural housing credit needs.

Wherever possible, USDA resources will continue to be targeted to those most in need. For instance, housing assistance for moderate income borrowers will be reduced, but housing assistance for low income people will remain at previously proposed levels. Furthermore, subsidized interest rates for these low income borrowers will be continued. Similarly, assistance to limited resource farmers, food stamp recipients, child nutrition recipients from low income families and other disadvantaged groups will also be protected, even though the food assistance programs are included in the general proposal to eliminate semi-annual adjustments due to price inflation.

USDA's important role in helping to meet the nation's energy needs will also be maintained. While general funding for our business and industrial loans is being reduced, the amount of that funding available for energy projects will be increased.

This is not to say that the actions proposed by USDA will not cause distress in many quarters. The program actions being proposed involve some short-term discomforts for most of our client groups. For instance, we have proposed deferring or reducing construction programs. The result will be more limited assistance for water and sewer, watershed and other construction in rural areas. We have deferred new initiatives wherever possible including legislation to expand the Women, Infant and Children's program, and implementation of the new Rural Cable Television program. Some USDA credit assistance will become more expensive since the Department is moving to eliminate subsdized interest rates wherever such subsidies are not well justified.

The President has called for increased discipline in our use of resources and our demand for credit. Discipline is never easy but it is the key to winning

the battle against inflation. All those served by USDA programs including small businessmen, will share in the sacrifices, but not fully. Accepting the short-term problems in exchange for a long-term solution to inflation is not easy, but it is the preferred solution.

Mr. Hjort. While USDA's programs serve those who live throughout the United States and in many foreign countries, most of our assistance goes to those who live and work in rural America—the home of a disproportionate share of the Nation's small businesses. Although our programs provide assistance to those whose income levels range from very low to quite high, most of our efforts are aimed at those with low incomes or with limited resources. Almost all of the Nation's farmers meet the definition of a small business, and most of them conduct their business with firms in our small rural communities that meet the definition of a small business.

Therefore, most of what we do has either a direct or an indirect impact on small businesses.

USDA is a multimission agency. As I have noted in the testimony, we provide a significant amount of credit. This year it will be about $25 to $26 billion, including about $10 billion to farmers, for various farm operation-related purposes; about $2.8 billion to foreign buyers of our agricultural products; about $4.5 billion in rural housing loans with most of that reserved for low-income borrowers. About $6.5 billion this year is available for rural electric, telephone and communication loans; about $1.1 billion is available for business and industrial loans, and about $950 million will go for community facilities and water and waste disposal systems.

In those loan programs, our interest rates range from 1 percent on up to the prime. However, only in our loans to foreign buyers of our agricultural products do we have an interest rate equal to the prime. Most of our loans are at the cost of money to the Treasury, plus a fraction.

This year we also will be providing about $14 billion for the domestic food assistance programs—$9.5 to $10.4 billion of that will be either for the food stamp program or the special supplemental food program for women, infants and children.

There are several other programs and activities of the department which affect businesses.

In the section of our testimony addressing inflation and rural areas, we try to make two or three general points. The first is that, over time, rural areas have become more like urban ones. Therefore, many of the effects of inflation and of the policies to mitigate inflation will be felt similarly in urban and rural areas.

Second, we point out that in this last decade the resurgence of population growth has started to take place in rural areas after decades of decline. This growth is impacted by inflation because it means additional requirements for resources to provide for that expanding population.

As we all know, inflation generally hurts most those whose incomes are low and either fixed or not rising as fast as inflation also greatly affects business operators not in a position to pass higher costs on to consumers through higher prices. Rural America is hard hit on both those counts.

Rural areas and small towns have a disproportionate share of people with low incomes or those who are living on relatively fixed incomes. Moreover, one of the major businesses in rural areas—farming—is one where costs of production tend to rise with inflation while prices received do not. They are largely determined by short-run, supply/demand conditions.

Thus inflation generally tends to increase the cost-price squeeze on farm businesses. That, as I will discuss in a little more detail later, is certainly apparent this spring.

One of the major negative impacts of inflation is that it tends to shift the flow of capital from productive uses, which would be counter-inflationary, to inflation shelters. In rural areas, we again find what we believe is a disproportionate share of inflation-hedging. Land has become a favorite hedge against inflation. The dramatic increase in land values in recent years—it was 16 percent last year—has contributed to a large increase in farm estate debt, and absorbed a large amount of scarce capital that could have gone into more productive uses.

The third point that we would make is that, in the past, rural areas were spared much of the burden of sharply higher interest rates which prevailed in the big money markets during periods of high inflation rates. Rural banks used to obtain most of their funds from low-interest time and demand deposits, and thus could lend at low rates, somewhat isolated from the pressures of the major markets.

With the advent of the money market certificates and other devices which rural banks are increasingly using, interest rates in rural banks are rising very rapidly, following a pattern very close to what is happening in the general economy. This is an unprecedented rate of increase in interest rates.

The impact of sustained inflation on the structure of agriculture does have important implications. It very easily could lead to fewer and fewer small farm businesses and fewer small businesses in rural areas. That is mainly because established farmers with equity in land have the opportunity to buy out their smaller neighbors.

We are also seeing effects in use and management of water resources, particularly in areas where water supplies are being depleted by irrigation. That is creating difficult problems.

High interest rates also slow the demand for housing and other construction. The lumber industry and our national forests are starting to be affected by that situation.

One of our major problems today is within the agricultural segment of the economy. Not only are costs of production rising very rapidly—they went up about 16 percent on average for all of agriculture from 1978 to 1979; this year in total we do not expect them to go up quite that much—but they will go up at a faster rate for crop production. This latter point is because there is some holddown from last year in the livestock sectors prices that farmers are receiving for feed and for livestock are holding essentially flat this year. That is a two-edged sword. It means lower returns to those producers, but it also means their costs are not going up quite as rapidly.

Mr. LaFalce. Mr. Hjort, could I ask you to conclude in a minute or two?

Mr. Hjort. Certainly.

Because we had very, very large crops last year and because our livestock sector has expanded, we have product prices essentially flat in the face of extremely rapid rises in costs of production. The net effect is a severe credit crunch, particularly in the Upper Midwest of the United States.

We have been taking actions to try to offset that. We have been purchasing grain, in part to offset the suspension of goods to the Soviet Union. We have been encouraging farmers to place excess grain into reserve so it is available in subsequent years.

We have also participated in the overall anti-inflation program. In connection with that, we are trying to see to it that farmers do have operating credit this year.

We are trying to see to it that our housing assistance programs are maintained for the low-income borrowers. We are trying to insure that our low-income resource farmers, our food stamp recipients and others are not adversely affected, disproportionately affected by inflation.

We are also giving very high priority to energy and so on.

I believe, Mr. Chairman, that does essentially summarize the statement.

Mr. LaFalce. Thank you.

We started at 9. It is now 11. Congress goes into session at 11. The first bill up is going to be the international financial institutions bill, which I will be helping to manage. It came out of my subcommittee.

Therefore, I am going to submit my questions to both of you in writing and ask you to respond to them.

I do know that Representatives Mitchell and Addabbo have some questions that they would like to ask. Mr. Clark?

Mr. Clark. Thank you, Mr. Chairman. Congressman Mitchell apologizes for not being able to attend. As you know, he is deeply concerned with the present conditions as they specifically affect minority business.

To this end, Mr. Henson, I was interested in your testimony. I think you very correctly stated many of the problems affecting minority business. However, could you be a little more specific in terms of your estimation of the failure rate that will occur if, in fact, present economic conditions continue; that is, the failure rate for MBE's.

Mr. Henson. You are talking about in terms of an actual percentage?

Mr. Clark. Actual percentage, yes.

Mr. Henson. We do not have data on actual failures. I would hate to be in a position of having to predict at this point the numbers of minority businesses by percentage that might fail.

Suffice it to say that we would estimate that the 10 percent, for example, estimate by the National Association of Automobile Dealers is significantly low in terms of minority businesses. I think that we are talking about much higher than that.

Mr. Clark. Would you concur then with a rather conservative estimate of at least 20 percent to 25 percent? And that is being rather conservative based on the present conditions?

Mr. Henson. That is certainly conservative.

Again, let me point out that I am not an economist. We have not run a good data study on this.

Mr. CLARK. What specifics would you suggest based on the analysis and so forth that you have done, based on your presentation, and based on the present economic conditions, what specific recommendations would you offer to assist minority businesses through these very hard and trying times?

Mr. HENSON. Let me point out, first of all, that the Minority Business Development Agency is in fact an agency with very few programs that can have a direct relationship to increasing the availability of debt credit.

We interact within the Government as a policy developer, a policy coordinator, as a catalyst attempting to make things happen, and as an advocate for minority business at all levels of government and throughout the legislative branch.

Let me point out, however, that there are a couple of suggestions that I can think of off the top of my head. In conjunction with the administration's anti-inflation policy and the implementation of credit restraints with the Federal Reserve, we might suggest the expiration of differential margin requirements for commercial banks providing credit to minority businesses. Accompanying the differential margin requirements, a tiered interest rate structure could be implemented to reduce the cost of borrowing and increasing the availability of credit to minority-owned enterprises.

Once the Federal budget has been balanced, we think that a refundable investment tax credit should be considered to foster greater investment in plant and equipment. This would improve cash flow and stimulate productivity and employment, especially for minority-owned businesses.

Let me also point out that in the very short run vigorous enforcement of the Community Reinvestment Act would assist us in helping to solve the problem of reduced availability of credit.

Mr. CLARK. I was somewhat surprised that you did not also say strict enforcement of Public Law 95-507. But I am sure you will concur with that.

Mr. HENSON. From my perspective, counsel, you know that goes without saying.

Mr. CLARK. I have one final question. On page 3 of your testimony you mention that minority businesses heavily rely on debt capital.

Is it your opinion, be it professional or personal at the present time, that if, in fact, there is a shift or a reprioritizing of that debt capital to equity type financing, that that would in fact decrease some of the problems of minority businesses?

Mr. HENSON. Obviously, probably the major problem of minority business enterprises today is this heavy reliance on debt capital. This is a problem that is exacerbated by the inability of minority businesses to raise equity capital from the normal sources of investment in small businesses.

We have run a study. That study has indicated that, in fact, what we have all feared, what anybody who has been involved with minority businesses has always sort of known, is in fact true. The debt to equity ratio of minority-owned businesses is significantly higher than the debt to equity ratio of nonminority-owned businesses at the same industrial SIC codes and the same level of development.

The reason for that appears to be the inability again to raise capital by the traditional sources. The traditional sources, as most people I believe know, for raising equity capital to get businesses off the ground is friends, relatives, other business people within the community. Minority businesses have not been able to successfully do that.

Obviously, I believe that any effort to increase the availability of equity capital within the minority business community would be an effort that I could support.

Mr. CLARK. Mr. Chairman, in recognition of the time schedule that you are on, Congressman Mitchell, too, will submit written questions. Thank you.

Mr. LAFALCE. Mr. Trimboli?

Mr. TRIMBOLI. Mr. Henson, everybody has agreed that your statement is accurate and your statement clearly reflects what is out there right now, what may probably happen when the recession hits in full swing.

Your statement was approved also by OMB, was it not?

Mr. HENSON. That is correct.

Mr. TRIMBOLI. So, the administration also shares these views?

Mr. HENSON. That is correct.

Mr. TRIMBOLI. In view of that, has the administration developed or is it in the process of developing a comprehensive plan that would cushion the impact of the upcoming recession on minority business?

Mr. HENSON. Not at this time.

Mr. LAFALCE. Let me interject.

Yesterday I elicited from Mr. Milton Stewart, the Chief Advocate for Small Business, that he would prepare a national strategy to help small business cope with both the special problems of this unprecedented inflation and the anti-inflationary policies of the administration, which have definite dislocative effects.

As far as I am concerned, that, by definition, must include and should include special means in this national strategy of assisting minority business as part of small business. So, I would exhort you to work closely with Mr. Stewart, who will be testifying before this subcommittee on May 13 in the presentation of that national strategy.

Mr. HENSON. We would welcome the opportunity, of course, to work with Mr. Stewart. I appreciate your encouragement.

Mr. TRIMBOLI. As part of this national strategy, would you favorably consider any effort that would result in an increased share of Federal procurements going to high unemployment areas?

Mr. HENSON. Such as labor surplus set-asides?

Mr. TRIMBOLI. Exactly.

Mr. HENSON. The administration has been very emphatic. As you know, I have just returned from the Minority Business Opportunity Committee convention in Florida last night. The administration has made it very clear to these local Federal officials that the administration expects no stepping back from the $3.8 billion commitment that the President has given for Federal procurement to minority businesses. I think certainly that would include labor surplus set-asides.

Mr. TRIMBOLI. I do not understand that response. I know the $3.8 billion is a goal for Federal procure——

Mr. Henson. Which is an increase of $1.3 billion from what was accomplished last year.

Mr. Trimboli. For minority businesses.

What I am suggesting is that, since most minority businesses are located in high unemployment areas and these high unemployment areas will be more severely impacted by the upcoming recession, that it may be more beneficial to expand the labor surplus procurement program so that more procurements are set aside for competition solely among those firms located in those areas.

All I am suggesting is that I think that should be considered in the context of an overall plan to cushion the impact of the recession on small business and particularly on minority business, and that that should be represented to the administration for its review so that it could reconsider its position on the amendment.

I would ask that you surface that issue.

Mr. Henson. I appreciate your suggestion. I certainly will represent your view.

Mr. Trimboli. Thank you. I have no further questions.

Mr. LaFalce. That is the strong view of the chairman also.

Mr. Henson. Thank you, sir.

I regret that we have to bring this to a conclusion. That very important bill is on the floor now.

The subcommittee is adjourned.

[Whereupon, at 11:10 a.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

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IMPACT OF INFLATION ON SMALL BUSINESS

TUESDAY, MAY 13, 1980

House of Representatives,
Subcommittee on General Oversight
and Minority Enterprise of the
Committee on Small Business,
Washington, D.C.

The subcommittee met, pursuant to notice, at 1:05 p.m., in room 2359A, Rayburn House Office Building, Hon. John J. LaFalce (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN LaFALCE

Mr. LaFalce. The subcommittee will come to order.

This afternoon the Small Business Oversight Subcommittee will continue its hearings on the impact of both inflation and the administration's anti-inflation policies on small business.

Since this is Small Business Week, it is a particularly appropriate time for such a hearing. Last month, on April 16 and 17, our subcommittee heard testimony from four trade associations representing small business, from many owners of small businesses adversely impacted by inflation, from Federal agencies with small business programs, and from assorted other parties.

The testimony was useful in pointing out the plight of small businesses as they struggle to cope with unprecedented inflation and also with the consequences of the anti-inflation policies of the administration.

It became apparent to me at those hearings that small business was faced with an unprecedented crisis, a crisis that I thought demanded that we change the name of Small Business Week to Small Business Survival Week. Therefore, I introduced a resolution in the House of Representatives to that effect. It also seemed apparent to me that we needed a special strategy for small business, a national strategy, to help small business cope with the special problems of unprecedented inflation and high interest rates, coupled with the beginning of a very, very serious recession, one of the worst recessions we have had since the 1930's.

Therefore, I suggested to the Chief Counsel for Advocacy at the SBA, Mr. Milton Stewart, that he return to our subcommittee at a later date with specific proposals that, taken as a whole, could form a comprehensive and meaningful national strategy to help small business to cope with both inflation and anti-inflation policies. That is why we are here today, to hear the statement of Mr. Stewart and what

I hope will be at least the beginnings of a national strategy to get small business through this most difficult period of time.

Mr. Stewart, please proceed as you wish.

TESTIMONY OF MILTON D. STEWART, CHIEF COUNSEL FOR ADVOCACY, SMALL BUSINESS ADMINISTRATION; ACCOMPANIED BY ROBERT E. BERNEY, CHIEF ECONOMIST

Mr. STEWART. Thank you very much, Mr. Chairman.

We appreciate very much your patience in extending to us this opportunity to continue our initial efforts to pull together the elements of the strategy which we hope to describe briefly.

Mr. LAFALCE. At this point, Mr. Stewart, your entire statement will me inserted in the record.

[Mr. Stewart's prepared statement and attachments follow:]

PREPARED STATEMENT OF MILTON D. STEWART, CHIEF COUNSEL FOR ADVOCACY, SMALL BUSINESS ADMINISTRATION

MR. CHAIRMAN AND MEMBERS OF THIS SUBCOMMITTEE:

There is attached a statement on inflation with some suggestive comments relevant to small business. It is a useful first draft prepared substantially by our Chief Economist, Robert Berney. (Appendix 1).

We have included some basic data -- much of it preliminary and tentative -- which provide significant sigh posts toward the small business survival strategy which you asked us to address.

These notes, on which I shall elaborate orally, are intended to outline some of the key elements of a small business survival strategy. It will be clear that our ability to formulate such a strategy is presently limited. The reasons are obvious: we are trying to do so at what is probably the most difficult time period in the economic cycle: it appears that small business is in a deepening recession while the economy as a whole still fights the ravages of inflation. It cannot be said too often that the data and the records of experience which we need are not available in the forms we need them. In two or three years (thanks to the President's directive that a "Small Business Data Base" be established) we hope to have reduced that problem materially. We ourselves are still very much students of the problem, learning as we go. Our staff resources sharply limit what we can do quickly, given the time we have had and the other responsibilities which we have.

None of this is to suggest that we have no strategy. We do. It means only that we will be doing our best to develop it more fully as we go along. We have three goals: to limit the damage done to the small business sector by inflation and anti-inflation measures in the immediate future; to push for policy review and revision on longer range "structural" inflation elements; and to enable those who come after us to be better prepared for the kinds of problems which we are today trying to deal with, substantially by improvisation.

Many of the specific comments made here do not necessarily represent the views of either the SBA or the Administration.

A. INFLATION IN THE ECONOMY, RECESSION IN THE SMALL BUSINESS SECTOR: BANDAIDS AND TOURNIQUETS.

1. Expanding the "Survival Defense" Capability of Small Business.

In most parts of the country which have felt the increasing shocks of recession and credit restriction during the past seven months, the dominent symptom for small business is cash flow restraint. We are trying first to help as many troubled small businesses as we can to save their own lives with help in cash flow management. For many firms, particularly those in the industries hardest hit (small farmers, automobile dealers, home builders, and industries related to them) the problem is not maintaining profitability. It is meeting the shortening of credit by suppliers, the lengthening of demand for credit by consumers and the increasing cost of financing the expanding cash flow from the banking system. The greater dependence of small business on debt as against equity is documented in the statement attached.

What we do here by way of exchanging information among small business people and their organizations about how to preserve cash flow is truly "Operation Life Line." Obviously every small business' ownership/management is its own best ultimate doctor. But we can speed information exchange, reduce government response time, and try to influence those who can help to do so in a timely way.

About three weeks ago we called to Washington the first members of a Task Force on Small Business and Economic Stability. We have named to it some twenty experienced small business people--some of them were here with us in our first appearance two weeks ago. The "mission statement" and press release announcing formation of the Task Force are attached as Appendix 2. This is not a reporting writing group. It is not to be a research and study group. It will be a community action group working with the local government agencies and the local business organizations to help small business, community by community. We expect to expand this task force until it has members in all or almost all of the Standard Metropolitan Statistical Areas. There is attached (Appendix 3) a first draft of a publication called "Protecting the Small Business Cash Flow Life Line." We will get it out as quickly as possible, after we have circulated it among the members of the Task Force and other specialists who may contribute to improving or correcting it.

As Appendix 4 there is attached the announcement of an all-day meeting in up-state New York sponsored by the Small Business Institute of Chatauqua County called "How to Weather the Current Economic Storm." The meeting was held yesterday in Mayville, New York. It was sponsored by Jamestown Community College, Chautauqua County Business Extension Service, U.S.

Small Business Administration, Chautauqua County SCORE Chapter and the State University College at Fredonia. We expect, with our SBA Management Assistance colleagues, to be stimulating programs like this one elsewhere in the country on an accelerated basis. We have also begun to discuss a cooperative program between SCORE "alimni" of specific industries and the trade associations in those industries. We need to be able to draw on more specific industry expertness throughout the country than is yet easy or even possible.

Last fall, the Administrator sent to SBA field personnel and to the nation's commercial banks two letters that are relevant here. (Appendix 5). Since then, he has continued to emphasize that SBA must shift gears in this period from helping new businesses to start to the preservation of existing businesses. He will be emphasizing and reemphasizing the points made in his letters again and again. The most important contributions to be made to this effort will come from the members of our small business task force themselves. We seek members who have met and licked specific cash crunches themselves and know how it is done practically. We hope to exchange among them specific suggestions of things that have worked in one or another place.

For example, we know that some banks have continued to provide two-tier interest rates even during the steep climb in those rates. We still think this step makes sense on an experimental basis, and at least some banks have told us that it works well for larger institutions.

We also plan to encourage a step taken by at least one bank with one of our task force members. At a time when his ordinary 90-day working capital note was "renewed" to twenty-three percent, he and his banker worked out a deferred payment plan. It was agreed he would be charged twenty-three percent on his books and the banks books. His monthly payments however were at the rate of sixteen percent with the balance added to the principal amount of the loan. They agreed that he would begin to reduce the principal amount as soon as the prime rate fell to sixteen percent. This appears to be a small step, but it is the kind of small step that can ease cash flow problems for thousands of firms.

A second example of what we hope to achieve here involved another member of our task force. He very happily paid a handsome productivity bonus to the employees of his manufacturing business not long ago. He than called them together and said in effect, "Most of you will take your bonus checks and deposit them in a savings acount where they may draw, seven, eight or nine percent. At the same time your company is having to pay over 20 percent interest on its loans. Why not lend us the amount you have been paid for your productivity bonus and the company will pay you fourteen percent." (The figures here are illustrative.) What is important is that, as we understand it, every employee agreed to make the loan.

You don't make headlines or legislative history by facilitating steps like these. But they are the steps that mean the most to the small business person on the firing line.

2. Improving the Ability of Small Business to Deal with the Financial Community

Our Administrator last week brought to Washington a representative group of bankers from around the country. They met with the Vice Chairman of the Federal Reserve Board, a member of the Council of Economic Advisers, the Controller of the Currency and the operating management of SBA's various divisions, as well as Treasury personnel. They provided useful information and experience to every Federal official with whom they met.

The task force referred to above had held similar meetings with the same agencies. In every case, I think it is fair to say that the Federal officials at the policy level heard statistics and specific cases which gave them a better application of small business' present position and needs. We shall draw on the successful experience of members of the task force in Kansas City where they have been working for many months on the problem of economic stability because they were delegates to the White House Conference on Small Business. With our encouragement, they began meeting with the management of the Federal Reserve bank of Kansis City several months ago. A formal regular meeting schedule is now followed. Members of our task force as it grows will be meeting with all of the Federal Reserve bank managements, as well as the managements of commercial banks and savings institutions.

Again and again we have found that when small business meets with the managers of the financial institutions in each community, there is a perceptible improvement in the performance of those institutions. Because small business is local and regionak, these people can do as much or more to improve the economic climate for small business as anyone.

3. Work to make SBA Policies as Supportive of Small Business Survival as the Law and Business Prudence Permit.

The letters from the Administrator referred to above are reinforced by day to day contacts among our financial and investment headquarters personnel, our Regional Administrators and our District Directors. Many of them have had long experience with the kinds of problems small business faces now. They may be relied upon to make use of that experience to keep SBA as responsive as possible.

4. Encouraging Other Relevant Federal Agencies to be as Responsive as Possible as Quickly as Possible.

We will shortly be sending a letter along the lines of the one attached as Appendix 6 to all of those responsible for procurement in more than 40 Federal agencies. What we will be urging is that they make a special effort to see that to the extent the laws and prudent management permit small business be paid first and fastest. Some agencies have made notable progress in shortening the time for payment for small businesses; others have far to go. As our letter indicates we will be urging a special effort at this time of small business cash flow stringency.

We are also planning to have discussions with representatives of agencies in the Federal Financial Institutions Examination Council. That group, by their attitudes during auditing, can have a material impact on the attitudes of banking institutions toward small business loans.

5. Expanding the Flow of Small Business Credit by Expanding the Secondary Market for SBA's Guaranteed Loans, the Number of Banks in the Bank Certification Program and the Number of Licensed Lenders.

In the short run the stream of commercial credit to small business performs a substantial part of what the equity market does for larger companies.

We hope our task force members will help to expand the level of bank participation in SBA guaranteed loan programs, and will help to expand the number of banks in the bank certification program. There are the readiest tools available to help banks, particularly smaller ones, to continue to serve small business while maintaining their own liquidity.

B. THE ICEBERG OF "CORE" INFLATION

Any small business strategy must obviously relate to general anti-inflation policies. The present Administration had had as hard a road to hoe with respect to this problem as any Administration in history. What policies small business itself thinks will help it most were made plain by the delegates to the White House Conference on Small Business. They urged Federal expenditure limitation, deferred Social Security tax increases and two-tiered minimum wages, among other things. They also urged a substantial change in the Federal regulatory climate and the establishment of two-tiering of regulations and the sunsetting of agencies and programs.

Our general discussion of inflation refers to a Joint Economic Committee report which distinguished "core" inflation from "demand" inflation and "shock" inflation. That report concludes with an endorsement of several tax proposals designed to encourage capital formation as a central problem. In the same way, the White House Conference made six reform recommendations to make small business more attractive to investors.

It is my own view that the concept of "core" inflation and remedies for it, must be carried one critical step beyond the point suggested by Dr. Eckstein's JEC study.

We believe that the long-range national attack on inflation must begin with an understanding that there are two distinct parts to the private sector. One consists of small and middle sized firms and the other consists of what we call "government sized business." In general there are approximately 250,000 such businesses; they employ 5,000 or more people each and their sales and assets exceed $2 billion each.

Three key concepts are needed to make our future anti-inflation strategy:

(1) The small and middle size business sector neither creates not fuels inflation, It is a significant anti-inflation force because of its competitive vigor and because of its innovative product and process creativity;

(2) The competitive small business sector has, as the data in the attached paper shows, been increasingly crowded from two sides; the government and government-sized business. While our specific measures of this crowding are still tentative, they confirm the general suspicion of all small business people.

It is this expansion of non-competitive, non-market government on the one hand, and the parallel "limited competition" administered price market dominant government-sized business on the other, that contribute, in my view, to core inflation.

(3) It follows that any long-range anti-inflation strategy must rest on policies which will expand the small business sector faster than that of either government, government-sized businesses, or both together. It is my view that our failure to do this during the past twenty years is what has produced the first decade-long inflation in the history of the Republic. External factors like the cost of fuel have added enormously to the problem. The problem would be there in a lesser form even if those external factors did not exist.

Can we realistically expect in the next decade to expand the small business sector while holding down the size of the government sector and the size of the government-sized business sector? I believe we can by making significant adjustments in five or six critical public policies. Every one of them is reflected in greater or lesser measure in the 60 recommendations of the White House Conference on Small Business.

What we must do above all is to make small business more attractive to investors. We need to shift Federal (and ultimately State and local) policies which have made the government-sized business part of the private sector artificially more attractive for capital formation and investment than small business.

You can see what happens when you look at the cumulative impact of taxes on manufacturing businesses of different sizes. Eighty percent of our manufacturing assets are now owned by the 500 largest industrial firms in the country. The other twenty percent is shared by 290,000 small firms. That did not come about, in my view, because of efficiency differentials produced by size of plant. It came about for a variety of reasons having to do with public policies, particularly taxes. If you were a manufacturer in 1974, the ratio of your equity or net worth to your total tax burden was determined by the size of your business. If your gross sales were less than $500,000, your total tax burden came to about 30 percent of your net worth. If your gross sales were $5 million, the total tax burden was roughly 20 percent of your net worth. But, if your gross sales exceeded $1 billion, the total tax burden was about 11½% of your net worth.

It is here that we find one of the keys to the disquieting but apparently increasing concentration of equity and liquidity in larger firms. Tax policy has been making it harder and harder for small firms to retain earnings and to add to equity for a long time. While it is not the only factor by any means, it is, in my opinion, probably the single most important one.

Those who advocate changes in business tax policy would be well advised to graduate whatever tax policies they propose to change, conferring the largest possible benefits on the smallest firms and adjusting them by size as the business grows.

Congress has taken the first step in this direction with respect to the corporate income tax. We have next to apply the same principal to capital cost recovery, capital gains and other business taxes.

Similar strategic changes in policies affecting procurement can be made to help small business contribute more to productivity and small-scale innovation. Once it is understood that the private sector consists of two parts and not one, the compelling need for a two-tier system of capital formation measures and credit management measures becomes clear. Add regulatory policies, foreign trade support policies, entrepreneurial education policies and you wind up with the range of policy modifications that comprise the critical elements in a small business anti-inflation strategy.

It all begins with a recognition that small and medium sized business, unlike big business, big labor and big government does not create or fuel inflation.

C MEETING INTERNATIONAL INFLATION FACTORS: AMERICAN SMALL BUSINESS FIRST: A STRONGER INTERNATIONAL COMPETITIVE SECTOR SECOND.

What has been happening to the small business sector in the U.S. has been paralleled in the rest of the world. As we have become a significant world political and economic power we have given priority to policies which facilitate the growth of multi-national corporations. In the rest of the world, larger and larger shares of the world economy are directly controlled by government or by government-sized multi-national business. We need international applications of the same key policy elements suggested above.

First, we need to strengthen the relative attractiveness to investors in international U.S. small businesses compared with overseas multi-nationals.

Second, we need to strengthen small business participation in world markets. SBA, Commerce, Export-Import Bank and OPIC are now working in this direction. It is estimated that there are still at least 20,000 small firms in this country whose products could be sold abroad profitably and are not yet in the world market.

Third, we must specifically target the "inflation cancers" which originate abroad for high priority counter attack, particularly by small high technology American firms. Notice the relative importance of price increase in fuels and commodities compared to labor in Table 2 of Appendix 1 (page 6). The only way we will ultimately liberate ourselves from overseas oil blackmail, or blackmail based on other scarce raw materials, is by a far more rapid rate of technological substitution than we have yet been able to achieve.

1. What is Good for Fighting Inflation at Home is Good for Fighting it Abroad.

A key element of our foreign economic policy should be -- as it never has been -- the building internationally of a small business sector to offset the economic roles of both national governments and government-sized multi-nationals. We have every good reason as a people to want to give the people of the rest of the world the opportunity for choice and for entrepreneurship. Almost everything we have done in the rest of the world since World War II has lead to the expansion of the government sectors or government-sized multi-national corporations. A vigorous international small business sector rooted in growing competitive small business sectors of nationaleconomies wherever they are possible will help greatly.

We shall be working to fill in this outline of key elements in a small business survival strategy. This is obviously not a subject for pat answers or quick fixes.

APPENDIX 1

THE IMPACT OF INFLATION ON SMALL BUSINESS

ROBERT E. BERNEY
CHIEF ECONOMIST
SMALL BUSINESS ADMINISTRATION

The Nature of the Inflation Problem

The inflation facing us today is a mixture of cyclical and secular forces. The cyclical factors causing inflation are the ones which we have dealt with in the past using our traditional demand management schemes, fiscal policy and monetary policy. The President has provided the leadership to tighten up fiscal policy and has encouraged the tightening of monetary policy to stem the rapid increases in prices.

Superimposed on these cyclical factors have been a series of supply shortages--such as in energy--which have weakened the effectiveness of our traditional demand management tools. To help offset this types of inflationary pressure, the President has established a set of voluntary wage and price guidelines. Small business is expected to comply but is exempt from the record keeping aspect of the guidelines.

The secular factors causing inflation are much more difficult to understand and to deal with. But they are reflected in a significant reduction in the productivity of our labor force and the competitiveness of our economy.

A recent study by DRI (Data Resources, Inc.) for the Joint Economic Committee (Tax Policy and Core Inflation), April 10, 1980 calls this long-run inflationary problem "core inflation." Their analyst usefully separates out a core inflation component, one short-coming in their analysis is that they do not analyze how the component parts of inflation, and therefore the policies needed to correct them, should be structured by firm and industry criteria. Nor do they analyze how the impacts of corrective policy fall unequally on firms of varying size. These are the problems which I want to address today.

Inflation and Small Business

The National Federation of Independent Business (NFIB) has been asking their members since 1973: "What is the most important problem facing you?" Since that time, inflation has always been listed as the number one problem. Clearly, the inflationary problem is not just a cyclical one. But the problem has been getting worse in recent months. In the first quarter of 1978, only 25 percent of the people responding to the question listed inflation as the most serious problem. In the first quarter of 1980, 35 percent ranked inflation as the most important problem. (See Table 1.)

How does inflation compare to the other problems that are ranked by small business owners? According to the NFIB survey in Table 1, their NFIB members rate inflation as 2.3 times more serious than "taxes" as a problem, and 3.9 times more serious than "regulation" as a problem. It is 2.2 times more serious than "obtaining necessary financing."

When monetary policy is used to control inflation, the problem of obtaining financing increases. In the first quarter of 1978, only 5 percent of the respondents said that "financing" was the most serious problem facing them. In the first quarter of 1979, 11 percent of those responding said "financing" was the most serious problem. Now that percentage is up to 16 percent, equal to the highest ranking in 1974. The more effective monetary policy becomes, the more serious this problem will become to the small business owner.

One input price (i.e., Cost of Production) which has been rising rapidly is, of course, the cost of energy. As it shows in Table 2, energy costs increased over the last year by almost 56 percent. But energy is not the only input price that has been increasing significantly. The cost of both capital and credit went up by over 26 percent the last year. And for the last four months (January-April, 1980) the cost of both long-term capital and bank credit has been increasing at an annual rate of over 70 percent. However, rates have been declining significantly in the last month. On the other hand, raw materials and industrial commodities prices have been increasing at a rate of some 20 percent. For firms trying to increase their productivity by adding to their capital stock, the cost of machinery and equipment went up an annual rate of almost 15 percent last quarter. Most machinery and equipment purchases of small business are financed by borrowing from banks and, as mentioned earlier, these costs are up by more than 70 percent in the last four months.

TABLE I

MOST IMPORTANT PROBLEM

	1973	1974				1975				1976				1977				1978				1979				1980
	4	1	2	3	4	1	2	3	4	1	2	3	4	1	2	3	4	1	2	3	4	1	2	3	4	1
INFLATION	24%	23	29	36	41	37	28	27	29	28	25	25	24	24	28	27	25	25	32	33	34	37	36	39	37	35
TAXES	13%	10	10	10	8	11	18	19	16	17	21	22	20	21	21	19	21	22	20	21	18	15	16	15	14	15
REGULATIONS	11%	8	8	8	6	9	10	12	12	13	16	14	7	12	12	12	11	12	11	10	10	9	8	9	7	9
COMPETITION	10%	8	10	8	6	8	8	8	8	10	9	9	13	10	9	9	8	8	8	6	8	6	6	5	6	5
LABOR QUALITY	13%	10	10	8	7	5	5	6	6	6	5	5	10	6	7	7	9	7	8	8	8	7	8	6	8	5
FINANCING	10%	8	6	12	16	13	10	8	10	8	6	7	7	5	5	4	5	5	5	7	7	11	10	9	13	16
DEMAND	N.A.	*	*	1	1	1	8	6	6	5	4	3	5	4	3	5	4	4	3	2	2	2	2	2	2	3
COST OF LABOR	7%	3	5	4	2	4	5	5	5	6	6	6	7	7	6	8	9	8	7	7	7	7	6	5	5	4
SHORTAGES	N.A.	23	15	9	6	4	2	2	1	1	1	1	*	2	1	1	1	1	1	1	1	1	3	5	2	3

*less than .5%

Source: National Federation of Independent Business

Some important cost increases with which the small busines owner must contend are not just a function of the marketplace. They are due to government policy. For instance, the tight money policy imposed by the Federal Reserve on October 6th and March 14th have obviously increased interest costs. In addition, on January 1, 1979, the minimum wage went up from $2.65 per hour to $2.90 per hour (an increase of 9.4 percent). On January 1, 1980, the minimum wage went up again to $3.10 per hour, an additional 6.9 percent increase. Social Security taxes have increased significantly. First, the wage base for the tax calculations increased from $17,700 to $22,900 in 1979, an increase of 29 percent. At the same time, the tax rate went from 6.05 percent to 6.13 percent, a 1.3 percent price increase. And in 1980, the Social Security tax base increased again to $25,900, an additional 13 percent increase while the tax rate held constant. Because smaller firms tend to be more labor intensive and use labor more affected by these government-mandated cost increases, smaller firms are likely to be more impacted by these policies than larger firms. (On the other hand, smaller firms are less likely to have a large portion of their work force unionized.)

These rapid increases in input prices have meant that small businesses have been forced to increase their prices. According to William C. Dunkelberg, of Purdue University "The prospect for inflation has never been worse." "Based on planned price increases reported in January, the rate of inflation for nonfood items can be expected to average over a 14 percent annual rate through next April. The proportion of firms planning to raise prices increased to 46 percent, a record level in the seven year history of the surveys. Twenty-four percent of the firms plan increases of 5 percent or more, a jump of 11 percentage points from the January 1979 survey. Eight percent of the firms plan increases in excess of ten percent."

Table 2

Annual Rates of Change of Input Prices Affecting Small Business

	Last Month (Jan-Feb)	Last Quarter (Nov.-Feb)	Last Year
Fuel and Related Products	59.5	47.2	55.6
Credit (Prime +3%)	25.2	1.7 (Jan-Apr) (76.8)	26.3
Capital (Moody's Baa)		52.7 (Jan-Apr) (70.4)	
Industrial Commodities	23.5	24.4	19.3
Raw Materials (Spot Prices-13 raw industrial)	23.9	24.3	17.9
Machinery & Equipment	13.7	15.7	11.2
Payrolls (Average hourly earing-private non-ag. payrolls)	9.6	6.9	7.7

Source: Survey of Current Business. March 1980, pgs. S-6, S-13, S-16. (January - April Data inserted as latest available information and are from the St. Louis Federal Reserve.)

The rapid increase in costs and prices generally puts small business at a disadvantage relative to large business. Small businesses are normally concentrated in the most competitive sector of our economy and therefore are "price takers." That is, the small firms' prices are normally set by the interaction of many suppliers and many demanders in a competitive marketplace. No single firm can affect the price in the competitive sector. Large businesses tend to be in less competitive markets and consequently have more market power to pass on higher prices to the ultimate consumer. Consequently, inflation tends to lead, in the short-run, to a more serious cost-price squeeze as the profits of smaller firms decline relative to larger firms and a more serious cash-flow problem develops for the smaller firms. This is why adequate credit flows are so crucial to the small firm.

The Impact of Monetary Policy on Small Business

The small business community agrees that inflation needs to be controlled since it is their number one problem. However, the cost of control may be too high for many small firms to bear if monetary policy, with its high interest rates, is the primary policy tool being used.

We agree with recent Federal Reserve actions which will serve to: 1) maintain reasonable availability of funds to small business, farmers and others without adequate access to financing; 2) maintain adequate flows of credit to the smaller correspondent banks and thrift institutions serving agricultural areas and small business needs: 3) limit financing of corporate take-overs or mergers and the retirement of stock, except in those limited instances in which there is clear justification in terms of economic efficiency; 4) limit financing of purely speculative holdings of commodities or precious metals or excessive inventory accumulation out of keeping with normal operating needs and; 5) restrain the growth of commitment for backup plans in support of commercial paper. The Office of Advocacy appreciates this recognition and we applaude the Board for suggesting that banks limit the adjustment of their lending rates and other terms to take account of the special needs of small businesses, including farmers and others.

Nevertheless, in spitr of the Federal Reserve's requests to the commercial banks, we are concerned that the cost of controlling inflation is falling most heavily on the smaller firms who can least afford it.

Small vs Large - Balance Sheet Effects of Credit Restraints

Some of the evidence of the potential for a disproportionate impact of monetary policy on small firms has been presented at earlier hearings. For instance, as is shown in Table 3, the debt-equity ratio for small manufacturing corporations is five times larger than the largest firms (for the asset size class under $25,00, there is a debt-equity ratio for 2.99; for the asset size class over $1 million, there is a debt-equity ratio of .57); in construction, the smallest firms have a debt-equity ratio of almost 3 1/2 times the largest firms. From the evidence it appears that the smallest firms in an industry are more dependent upon debt instruments than the largest firms and therefore, are more sensitive to a tightening of credit supplies and the increased cost of credit.

Further evidence is shown in Table 4 which demonstrates that the smaller manufacturing corporations are more dependent upon current debt than large manufacturing corporations. In the latest time period that was available from the FTC's Quarterly Financial Report, manufacturing corporations with under $5 million in assets had a current debt to total asset ratio of 1.56 times the largest corporations (over $1 billion in assets). While this ratio has been declining recently, it shows that the smaller the corporation the more it is affected by increases in short-term money market rates. Consequently, the 220 percent increase in prime rate which had occured since 1977 when the prime rate peaked at 20 percent would appear to be more of a burden on the smaller firm than larger firms.

Finally, Chart 1 shows that the proportion of bank indebtness to total corporate debt has increased significantly over the last 20 years for the small manufacturing corporations. For all manufacturing corporations--essentially the large corporations--the ratio has been declining since 1970. There are also indications in Chart 1 that large manufacturers borrow more heavily from commercial banks during tight money periods as they rely on their lines of credit more heavily. At the same time, it appears that the share going to smaller corporations declines, indicating that the large firm is crowding out the smaller corporation.

Inflation Distress Warnings for Small Firms

Unfortunately beyond this basic evidence there is not enough substantive knowledge about the impact of tight credit policy on firms of varying size and there is almost no aggregate data available on a timely basis to measure the impact of tight money policies on the small business community.

For example, is the small retailer more affected than the large retailer by the 15 percent special deposit on the expansion of credit card purchases? Will the extension of reserve requirements to nonmember banks have a greater affect on lending to smaller firms than larger firms? Since small banks tend to have a higher proportion of their portfolios in small business loans, this form of monetary restraint may have significant un-neutral effects on small firms. But, the impact is serious and evidence is reported regularly in the Wall Street Journal, the business sections of local papers and trade association journals. They report many detailed case studies of firms being forced to significantly cut back their operations or close their doors, permanently. The impacts appear to be most severe for the small firms connected with the housing industry, the agricultural sector and automobile manufacturing and sales.

We are now developing some aggregate measures as indices of small business distress so we can determine the seriousness of these stories for the small business community as a whole. While we are in this development period, the best index we have currently is the rate of change in the filings of business bankruptcies. (Since most businesses are small and an even higher percentage of firms which fail are small, bankruptcy data appear to be a reasonable proxy for small business distress).

Unfortunately, we only have a comparable set of numbers from October 1979. But earlier series do not indicate a strong seasonal pattern, so comparing rates of change from October is a reasonable first approximation. Table 5 shows that the number of business failures have increased by 48 percent since the Federal Reserve's credit tightening policy on October 6th. An analysis of the data series show that bankruptcy filings lagged the policy change by two months.

If we construct monthly totals from Dun and Bradstreet weekly failure data for a comparable time period (October through March) we find that failures increased by 39 percent. Consequently, it is clear that something serious is happening to small business.

But how many small firms are likely to be affected? Dave Birch has estimated that an average of 400,000 firms fail each year. If we assume that this long-run failure rate increases by 1/3 because of the October tightening of credit, then some 133,333 additional firms will close their doors.

If we also conservatively estimate that the March 14th policy changes have a no more serious impact than those of October 6th, then another 133,333 firms might fail: a total increase in failures of 266,666. Assuming that the average firm which failed has 12 employees and sales of $855,000 (the average for the 0-500 employees firm in Birch's Dun & Bradstreet data base) then the impact of tight money policy is likely to mean a loss of 3.2 million jobs and $228 billion in lost sales.

These estimates are obviously crude approximations. We wish more accurate data and modeling techniques were available, but they are not. This may be an appropriate time to raise the question of why nots? Until we can develop more sophisticated indicies and gather more accurate firm size aggregate data, these are our best guesses on how inflation and the resulting tight money policy are affecting small business.

Core Inflation and the Crowding out of Small Business in our Economy

It is clear to me that the decreasing share of GNP being produced by small business, generally and the increasing share of GNP being produced by large business and government--the non-competitive or less-competitive sectors of our economy--are a major component of core inflation.

Joel Popkin and Company has been developing, under a research contract with Advocacy, estimates on how GNP is allocated between large and small firms. In his initial set of estimates, he has defined "small" as firms with fewer than 500 employees. Currently, we have the information for two benchmarked years, 1963 and 1972. And we have preliminary estimates for 1976. This data show that the share of output being produced by small firms has been declining. It was 43 percent in 1963, it dropped to 40 percent in 1972 and was approximately 39 percent in 1976. We are seeing a decline in the share of GNP being produced by the small firms at a rate of approximately 0.4 percent a year. On the other hand, large business and government both showed gains in the 1963-72 period, with large business increasing its share by 2.4 percent and government growing by 2.1 percent. Our best estimates for 1976 show government production has declined, while the growth of large business has accelerated. In any case, there appears to have been a long-run decline in our more competitive sector and a long-run increase in our less competitive sectors. If we project these numbers out to the year 2000, small business will produce only 32 percent of our GNP, while large business will be producing 49 percent.

My own staff has taken Popkin's GNP estimates and has broken them down into more detailed firm size categories. What these results show is that almost all of the decline in the share of production of GNP has occured in the 0-19 employees-sized firms--the size of small business which appears to be extremely crucial in generating new jobs and we believe equally important in generating innovations, and in leading in the advances in productivity.

Almost all of the growth has occured in what we called "government-sized" business, which is any firm with average sales or assets over $2 billion. However, for the purpose of the estimates, we have defined government-size business as firms with more than 5,000 employees. Thus, the basic structural change which appears to be taking place is that the very small, very dynamic, very innovative smaller firms are being "crowded out" by the very largest firms. (See Table 6 for our preliminary estimates.) We do not believe there are significant economies of scale in production to account for these changes. Again, if these patterns of change continue until the year 2000, the very small firms will produce only 9 percent of GNP and the very largest firms will produce 38 percent.

Just recently, you heard from Howard Hjort, Chief Economist for the Department of Agriculture. He has apparently found similar trends of large firms crowding out small firms in the food industry. He stated: "Pure competition is diminishing and oligopolies are becoming more prevalent." He estimated that the concentration and resulting monopoly pricing cost consumers at least $16 billion in over-priced food. It is clear to him that structural changes in the agriculture industries are adding to core inflation.

I am frustrated with a lack of data on small business to prove my point, but I am convinced that the decline in productivity is somehow related to the change in competitive environment. It appears, to me, that we have less and less price competition and less and less competition to develop more efficient production processes—the kind of competition found in the small business sector, and more competition to maximize cash flows and the financial return on investment. The large firm with its depreciation flow has the necessary cash to expand plant and equipment. However, they can minimize their risks and maximize their return on investment by buying successful small firms, while avoiding the high risk and cost of start-ups.

Again, the preliminary work of Dave Birch has shown that large firms acquire the most rapidly growing small firms. After acquisition these firms tend to grow at a much slower rate. Unfortunately, we do not have data to show that the rate of innovation fell when the small firm is brought up by the large firm. But it is the feeling of the small business community that this is happening. Thus, the single most important factor causing the inflationary problems in our economy is that the most productive and innovative sector of our society is being acquired by a sector that is more concern with maximizing the return on existing technology and minimizing the risk of undertaking new innovations.

In addition, the government has been making it more difficult for the entrepreneur with a new idea to develop it and get it to market. We have preliminary evidence to show that the cost of regulation for small firms (less than 50 employees) is 7 to 10 times higher than for larger firms. In fact, it is our feeling that the net impact of all government policies discriminates against the smallest firms and discriminates in favor of the largest firms. The President has recently taken steps to correct this imbalance by having federal agencies assess the impact of their regulations on small firms before implementation.

International Structural Change

What is happening in the U. S. is unfortunately not unique. This share of output being produced by small firms (where the proportion of manufacturing employment in small firms is used as a proxy) appears to be declining in:

Norway
Canada
Sweden
Federal Republic of Germany
United Kingdom

only two contries show increasing small business shares;

Japan
Switzerland.

Core inflation here and abroad are due to significant declines in the competitive environment in the international sector brought about by such things as:

-the formation of the OPEC cartel and associations of other raw material producing countries to control prices;
-nationalization of key industries in the developing countries;
-protection of "infant industries" from world-wide competition;
-the growth of world-wide oligopolies

-the desire of all people to have real standards of living significantly higher than their economies can produce.

Inflation and Small Business - A Summation

In summary, there are three crises occuring in the small business community, today. The first crisis is caused by inflation. The second is being caused by the tight-money policy used to control inflation. The third crisis is structural paralysis. We are convinced that the changing structure in the business community is not generally due to production economies of scale. More likely it is due to artificial economies of scale created overtime by tax policy, banking policy, regulatory policy and procurement policy. Too often the policies taken by the Federal Government have an un-neutral effect on the smallest and most dynamic firms in our economy, creating artificial barriers to entry and impediments for expansion. These are the long-run structural changes which are contributing to the deteriorating climate for small business. The crowding out of the very small firms by the very large firms appear to me to be a root cause of inflation which will not be corrected by the desirable fiscal and monetary policies recently announced. To correct the long-run inflationary problems requires basic structural changes in our economy to improve the climate for small business.

TABLE 6

Percentage Share of GNP by Firm Size: 1963, 1972 and Preliminary Estimates for 1976 to 2000

	1963	1972	(1972-63)	Preliminary 1976*	1980	1990	2000
Small Business							
0-19 employees	21.0	18.3	-2.7	17.1	15.9	12.9	9.0
20-499 employees	22.1	21.7	-0.4	N.A.	N.A.	N.A.	N.A.
Total	43.1	40.0	-3.1	39.4	38.2	35.2	32.4
Large Business							
500-4,999	13.0	12.8	-0.2	N.A.	N.A.	N.A.	N.A.
5,000+**	27.2	29.8	+2.6	30.9	32.0	34.9	37.8
Total	40.2	42.6	+2.4	43.1	44.0	46.3	48.6
Government	11.1	13.2	+2.1	12.9	N.A.	N.A.	N.A.
Total Large Business and Government	51.3	55.8	4.5	56.0			
Other ***	5.5	4.1	-1.4	N.A.	N.A.	N.A.	N.A.
Total	99.9	99.9	0.0				

Source: Joel Popkin, "Gross Product Originating in Small Business" Detailed allocations made by the distribution of sales by firm size as found in Enterprise Statistics for 1963 and 1972.

*A detailed breakdown by firm size for 1976 GNP will not be available until the 1977 Enterprise Statistics data become available. However, there is no reason to believe that the basic trends for small and large business from 1963 to 1972 have change. If anything, the rate of change have accelerated because of the declining share of production by government.

**The +5,000 employee firm is a proxy for government-size business—a firm with an average of $2 billion in sales and assets. Of the Office of Advocacy list of 237 government-size firms, 221 firms had 5,000+ employees while only 16 had less than 5,000 employees.

***Agriculture, Households Rest of World, Unidentified.

APPENDIX 2

Mission Statement

TASK FORCE ON SMALL BUSINESS AND ECONOMIC STABILITY

Small business owners and managers, along with their fellow Americans, face a difficult and vexing time in our economy. None of us can tell how far the distress already being felt by some small businesses in some parts of the country will go. It appears to be spreading, although slowly, beyond the industries which were hit first and hardest by credit restraints.

The central missions of this task force will be to:

(1) Assist small business in maintaining its "cash flow lifeline" during the period of credit stringency;

(2) Contribute to the creation of a climate of stability and steadiness within each small business community;

(3) Serve as a local action and information group;

The basic goal is to minimize the number of small businesses which are laid low by the immediate credit crunch.

The steps to which we are asking members of the task force to give the highest priority are efforts in their own communities to help small business people preserve their cash flows during the coming months. The initial activity we are encouraging them to undertake is to meet with bank officers (and, if necessary, directors in their communities), to explore steps that are feasible and possible. We hope they will talk directly to SBA District and Regional offices, particularly about management consulting help for small businesses from SBA personnel from Score, ACE, in planning the best possible management of cash flows.

The specific missions of this task force will include, but not be limited to, the functions listed below:

(A) To monitor the comparative impact of inflationary factors or anti-inflation measures on small, medium and large business;

(B) To encourage banks and other financial institutions to take every step possible to permit the maintenance of adequate cash and credit flows by the largest possible numbers of small firms (e.g., partial temporary applications of interest to principal; SBA guaranteed lending programs--of Denver);

(C) To encourage local lawyers and accountants and their professional societies to provide appropriate help to small business on an organized, volunteer basis;

(D) To encourage trade association small business groups, Chambers of Commerce to help to inform the financial community as to the significance of the special measures taken by Federal agencies trying to help small business. As an example, the Federal Reserve Board has specifically said banks may exceed the six to nine percent business loan limits in order to help small business;

(E) To report to SBA's Office of Advocacy special distress level situations which center in particular places or groups of small businesses as a result of governmental actions or proposed actions;

(F) To speed the process of Office of Advocacy reporting to Federal agencies on these subjects to minimize the response time for required and feasible actions;

(G) To help the Office of Advocacy communicate to small business the facts and arguments about Federal anti-inflation policies;

(H) To help to develop a "small business discomfort index" made up of firm local data and informal task force members reports.

Members in the task force will be recruited from among small business people through three sources:

(1) Former delegates to the White House Conference on Small Business, with particular interest in economic stability;

(2) Trade Associations with substantial small business membership, and

(3) Small business organizations as such.

NEWS SMALL BUSINESS

Washington, D.C. 20416

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1441 "L" Street, N.W.

SBA # 80-27

FOR IMMEDIATE RELEASE
WEDNESDAY, APRIL 30, 1980

SBA'S OFFICE OF ADVOCACY ORGANIZED TASK FORCE TO ASSIST SMALL FIRMS WITH FINANCIAL PROBLEMS

WASHINGTON, D.C., April 30 ---- A Task Force on Small Business and Economic Stability has been organized by the U.S. Small Business Administration's Office of Advocacy to assist small firms across the country with their financial problems arising from credit restraints and high money costs.

Task force members, who include experienced small business persons and officials of small banks, will meet with bankers, accountants, and trade associations to devise ways to solve and minimize cash flow problems.

The Task Force also plans to discuss small business' financial issues and problems with officials of Federal Reserve Board branch banks around the country.

- more -

The basic goal of the Task Force is to minimize the number of small businesses which might fail because of the current nation-side credit crunch.

"Small business owners and managers face a difficult and vexing time in our economy," A. Vernon Weaver, SBA Administrator, said today. "None of us can tell how far the distress already being felt by some small businesses will go. It appears to be spreading beyond the industries which were hit first and hardest by credit restraints.

"The Task Force on Small Business and Economic Stability will be a community-oriented and action group. It isn't being formed simply to write a report. Members will work in their communities and regions to find ways to help small firms ease the unusually heavy difficulties more and more small managers are having raising money and meeting high interest costs."

Milton D. Stewart, SBA Chief Counsel for Advocacy who already has met with members of the Task Force, said "fighting at the same time a recession in the small business sector of our economy and inflation in the whole economy is not a simple matter. So the Task Force's mission can be described as 'Operation Cash Flow Lifeline' -- seeing that in these economic times small owners can find and keep enough cash to stay in business."

Stewart also said that the Task Force members "are small business persons and small bankers who have gone through credit problems before."

Stewart said the Task Force, which now includes about 25 members, will be expanded to several hundred in the coming weeks.

Weaver and Stewart said the basic missions of the Task Force will be to:

-- Assist small business in maintaining its "cash flow lifeline" during the period of credit stringency;

-- Contribute to the creation of a climate of stability and steadiness within each community; and

-- Serve as a local action and information group.

Stewart said, "The Task Force members will give the highest priority in their own communities to help small business people preserve their cash flows during the coming months. The initial activity we are encouraging them to take is to meet with bank officers and bank directors to explore steps that are feasible and possible. We hope that the Task Force members will talk directly to SBA Regional and District Offices, about management consulting help for small businesses."

Weaver and Stewart said specific Task Force aims include:

To monitor the comparative impact of inflationary factors or anti-inflation measures on small, medium and large businesses;

To encourage banks and other financial institutions to take every possible step to permit the maintenance of adequate cash and credit flows by the largest possible numbers of small firms;

To encourage local lawyers and accountants and their professional societies to provide appropriate help to small business on an organized, volunteer basis;

To encourage trade associations, small business groups and Chambers of Commerce to inform the financial community as to the significance of the special measures taken by Federal agencies trying to help small business. As an example, the Federal Reserve Board has specifically said banks may exceed the six to nine percent business loan limits in order to help small business;

To report to SBA's Office of Advocacy special distress level situations which center in particular places or groups of small businesses as a result of governmental actions or proposed actions;

To speed the process of Office of Advocacy reporting to Federal agencies on these subjects to minimize the response time for required and feasible actions;

To help the Office of Advocacy communicate to small business the facts and arguments about Federal anti-inflation policies; and

To help develop a "small business discomfort index" made up of firm local data and informal task force members' reports.

Present members are:

Mr. Halsey Smith
Northeast Bankshare
Association
Lewiston, Maine

Mr. Eli Mason
Mason & Company
New York, New York

Mr. John Gay
Gay & Huff Corporation
Peoria, Illinois

Mr. Bill Nourse
Brookmeade Hardware & Supply
Nashville, Tennessee

Mr. Wayne Williams
Williams Volkswagon, Inc.
Lansing, Michigan

Mr. Lindel Lay
Charter Mortgage Bank
North Little Rock, Arkansas

Mr. Philip Cline
J.H. Fletcher & Company
Huntington, West Virginia

Mr. Henry Wisenfeld
George W. King
Baltimore, Maryland

Mr. Mike Rukin
ASBC
North Little Rock, Arkansas

Mr. Ken Valis
Colorado Paint Company
Denver, Colorado

Mr. David B.H. Chaffe, II
Howard, Weil, Labouisse,
Fridericko, Inc.
New Orleans, Louisiana

Mr. Sam A. Pasch
Polacheck's (Clothiers)
Milwaukee, Wisconsin

Mr. Ron Piercy
A-D-E Lumber & Supply
Company, Inc.
Kansas City, Missouri

Mr. Joseph J. Grish
Service Station Dealers
of America, Inc.
Washington, D.C.

Mr. Marc E. Brown
Plas-Tanks Industries, Inc.
Fairfield, Ohio

Mr. Bob Carr
Systems Engineering
Association
Cherry Hill, New Jersey

Mr. R.L.T. Smith
Smith Supermarket
Jackson, Mississippi

Ms. Dorothy Parker
P & P Farms, Inc.
Royal City, Washington

Mr. Joel Popkin & Company
1100 - 17th Street
Suite 1000
Washington, D.C.

Mr. Santos T. Abrilz, Jr.
APOCA Industries
Deer Park, New York

Mr. Paul Macler
Macler Industries Incorporation
Friendship, New York

Mr. Harold B. Stone
Stone & Hinds, P.C.
Knoxville, Tennessee

Mr. Page Van Loben Sels
Western Asphalt Service
Rodeo, California

Mr. John Jardine
Whitehall, Montana

Mr. D. Bruce Adamson
Joplin, Missouri

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U.S. Small Business Administration

Office of Advocacy

PROTECTING THE SMALL BUSINESS CASH-FLOW LIFELINE

An Office of Advocacy Survey of 55 Management Practices
Recommended by the Private Sector During
Periods of Recession and Limited Credit.

May 1980

best copy available

Table of Contents

Introduction Page 1

I. Cash From Operations Page 2

Accounts Payable Page 2
Accounts Receivable Page 4
Cash Management Page 6
Charge Account and Check Management Page 7
Credit Card Management Page 8
Inventory Management Page 9
Purchasing Page 11

II. Cash From External Sources Page 13

Sources of Debt Financing Page 14
Sources of Equity Financing Page 16
Nontraditional Funding Sources Page 17

III. Federal Government Assistance Programs Page 20

U.S. Small Business Administration Page 20
U.S. Department of Commerce Page 22
U.S. Department of Agriculture Page 23
U.S. Department of Labor Page 23
U.S. Postal Service Page 24
Federal Emergency Management Agency Page 24
Overseas Private Investment Corporation Page 25
Export-Import Bank of the United States Page 25

IV. Bibliography Page 26

V. Checklist Page 30

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Introduction

Harvard University economists and corner store grocers are agreed on one point. That is that the long awaited recession of 1980 and the unprecedented cost of borrowing during the last six months have conspired to present small business managers with a difficult dilemma. The economic slowdown may well increase the need for working capital just as the credit crunch makes additional business borrowing almost impossible. The table, below, shows the combined effects of recession and tight money markets on the accounting statements of a small business.

Small Business Accounts During Recession and Tight Money

Uses of Funds		Sources of Funds
accounts receivable	(up)	availability of credit (down)
work-in-process inventory	(up)	
finished goods inventory	(up)	
interest expenses	(up)	
allowances for bad debt	(up)	

The urgent need of small business today is to find sufficient cash resources to weather the anticipated economic hardship of the next three quarters. The pages which follow are intended to provide small business managers with several dozen ideas for securing the necessary cash. The information provided is presented in four sections:

I) Cash from Operations

II) Cash from External Sources

III) Federal Government Assistance Programs

IV) Bibliography of Useful Publications.

The first and second sections list precisely 55 recommendations made by small business managers, management consultants and business scholars on ways smaller firms can cope with a cash crisis. The recommendations were offered in recent periodicals and small business textbooks. As helpful as some of the ideas may be, the Small Business Administration is not able to take credit for their origination. This publication does little more than summarize a sampling of small business tips from the private sector.

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I) Cash from Operations

Following the recession of 1975, Dun and Bradstreet conducted a study of the 11,432 business failures reported during the year. The study concluded that, while 73% of the failures involved either inadequate sales or some competitive weakness, fully 34% suffered from the mismanagement of operating expenses, receivables and inventory accounts. A list of the apparent causes of business failures is offered below.

Apparent Causes of 11,432 Business Failures in 1975 Recession

Apparent Cause	% of Failures
1) Inadequate sales	51%
2) Competitive weakness	22%
3) Heavy operating expenses	16%
4) Receivables difficulties	10%
5) Inventory difficulties	8%
6) Poor location	3%
7) Excessive fixed assets	3%
8) Fraud	1%
9) Fire	½%
10) Bad habits	½%
11) Marital difficulties	½%
12) Poor health	½%

George G. Eddy, "The Small Business Owner - What it Takes to Succeed," Texas Business Review, July-August, 1979, p. 114.

Correctly managed, the operating accounts can be a significant source for needed cash. 42 ideas for improved operations follow:

Accounts Payable

#1 Domestic Letter of Credit: The use of a letter of credit to guarantee extended payments to a supplier is common fare among multinational companies in their international transactions. In recent years, however, small firms have used letters of credit to prolong payments to their suppliers.

During the late 1970's, an East Coast computer manufacturer denied the credit purchase request of a West Coast software company. The manufacturer had determined that the purchaser's equity base warranted only a $20,000 extension of credit, $13,000 short of the purchase price of the equipment. After learning of the credit denial, the California firm asked its bank to address a letter of credit to the East Coast supplier guaranteeing payment in full. The sale was concluded immediately and the full credit extended.

#2 **Precision Timing for Payables:** A small business textbook on cash flow management offers three rules for precision timing in the payment of business bills:

- direct suppliers to submit bills the day following the monthly peak of receipts from customers. This permits payment of bills when the cash position is at its best and allows for investment of the remaining funds for the duration of the month.

#3
- resist employee requests to pay all suppliers on a single billing day. Never pay bills in advance of the discount date.

#4
- negotiate with your major or more dependent suppliers for an installment payment plan.

#5 **Third Party Payors:** Among the most serious cash flow problems faced by many industries is the system of delayed payments for ongoing work. This problem is especially acute for the housing contractor. Although a contractor may realize his greatest costs during the early months of construction, he is frequently paid on an even installment basis.

One solution is to establish a third party agent, often a title company, to make all disbursements. The title company pays all of the contractor's direct expenses as they are incurred. Profits are paid on a percentage completion basis.

Accounts Receivable

#6	Factoring Receivables:	During the last five years, small business managers have found their accounts receivables to be an increasingly important source of cash. The receivables can be sold, at a discount, to a financial institution for immediate funds. In the alternative, the receivables can serve as security for a straight bank loan. In either case, the use of receivables financing is no longer synonymous with desperation management. Across the span of sixty days, a small West Coast manufacturer saw his monthly sales of hula hoops climb from $25,000 to $1,000,000. Unprepared to back its client's growth, the firm's bank denied a loan to cover the necessary inventory expansion. Within a short period of time, however, the company was able to factor its avalanche of receivables to meet the new working capital requirements.
#7	Incentive for Collection:	A national accounting firm recommends that its clients increase or decrease their salesmens' commissions according to the number of overdue accounts serviced by each. The penalty and bonus create an incentive for the sales force to keep their accounts current.
#8	Stamped Envelope as Encouragement:	The same national accounting firm suggests that a stamped, self-addressed envelope enclosed with each bill may encourage customers to pay more promptly.
#9	"Tickler Method" for Collection:	A manufacturer of industrial control devices argues that it is often more effective to inquire, politely, when payment may be expected than to actually request payment. This reasoned-man approach, known as the "tickler method," is used frequently by credit managers of large corporations.
#10	Part-Time Credit Manager:	A small business magazine states that many of its readers cannot afford to hire a full-time credit manager. For these firms, the magazine recommends hiring a retired, professional credit manager who can serve the company during collection periods. His salary may be more than compensated for by the increased efficiency in bill collecting.

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#6	Factoring Receivables:	During the last five years, small business managers have found their accounts receivables to be an increasingly important source of cash. The receivables can be sold, at a discount, to a financial institution for immediate funds. In the alternative, the receivables can serve as security for a straight bank loan. In either case, the use of receivables financing is no longer synonymous with desperation management. Across the span of sixty days, a small West Coast manufacturer saw his monthly sales of hula hoops climb from $25,000 to $1,000,000. Unprepared to back its client's growth, the firm's bank denied a loan to cover the necessary inventory expansion. Within a short period of time, however, the company was able to factor its avalanche of receivables to meet the new working capital requirements.
#7	Incentive for Collection:	A national accounting firm recommends that its clients increase or decrease their salesmens' commissions according to the number of overdue accounts serviced by each. The penalty and bonus create an incentive for the sales force to keep their accounts current.
#8	Stamped Envelope as Encouragement:	The same national accounting firm suggests that a stamped, self-addressed envelope enclosed with each bill may encourage customers to pay more promptly.
#9	"Tickler Method" for Collection:	A manufacturer of industrial control devices argues that it is often more effective to inquire, politely, when payment may be expected than to actually request payment. This reasoned-man approach, known as the "tickler method," is used frequently by credit managers of large corporations.
#10	Part-Time Credit Manager:	A small business magazine states that many of its readers cannot afford to hire a full-time credit manager. For these firms, the magazine recommends hiring a retired, professional credit manager who can serve the company during collection periods. His salary may be more than compensated for by the increased efficiency in bill collecting.

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#11 Collection of Unearned Discounts: It is common practice among many industries to offer a discount to customers making payments within a specified number of days. It is also common practice for customers to take the discount even when it is unearned.

A small business in Connecticut discovered that it had lost several thousand dollars to unearned discounts. The firm management instituted a new policy of treating unearned discounts like past-due balances, sending out a second invoice in the amount of the discount. The strategy was successful; most customers agreed to forward payment and thereafter claimed discounts only when deserved.

#12 Calculate Tax Savings on Bad Debt: A fall, 1979 industry trade journal reports that most collection agencies now charge between 30% and 50% of all bills collected. Disturbed by such high costs of collection, several retail firms derived formulas to compare the net collections against a tax saving that might be earned in writing off the bad debt. Firms in high tax brackets may find that the Federal Government is more "generous" than the private collection industry. The table, below, illustrates the choice faced by a firm in the 40% marginal tax bracket.

Efficient Choice for Firm in 40% Marginal Tax Bracket

Collection Agency Discount Rate	Efficient Choice
30%	use collection agency
33%	indifferent
35%	deduct from taxes
38%	deduct from taxes
40%	deduct from taxes

Bruce R. Siecker, "Managing Customer Credit," Drug Topics, October 1, 1979, p. 38.

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Cash Management

#13 Bartering for Goods and Services: In 1979, a Los Angeles automobile dealer sold $260,000 worth of vehicles in exchange for $390,000 worth of advertising space. No money traded hands. The dealership belongs to one of several hundred barter clubs in the U.S. and Canada organized to trade goods and services among business members. Club memberships are becoming increasingly popular among small business managers as a way to conserve cash.

#14 Short-Term Cash Investments: Lacking the financial sophistication of the Fortune 500 companies, many small businesses allow their cash to rest in checking accounts, bearing no interest, or savings accounts, bearing interest as much as 13% below prime. There are, however, a large number of short-term investments which even the smallest businesses could afford to enter. For example, many of the stock brokerage houses offer "money funds," paying interest at rates between 10% and 20%. The "money funds" are especially attractive to small firms as they allow depositors to write checks against the account at any time. A brief summary of other investment opportunities is offered below:

Sampling of Cash Investment Opportunities

Type of Investment	Minimum Initial Deposit	Interest Rate May 8, 1980
Certificates of Deposit (six month)	$1,000	9.06%
Three Month Treasury Bills	$10,000	8.66%
Triple A Rated Municipal Bonds	$5,000	5.3% (tax free)
Money Market Funds	$5,000	11.82%

As minimum deposits and interest rates may vary from broker to broker and from day to day, the quotations provided above should be used only as an introduction to the possibilities.

For additional information, one small business magazine recommends the following toll-free telephone numbers:

800-223-5680 (Dreyfuss)

800-638-0660 (Commercial Credit)

Charge Account and Check Management

#15 **Discontinue Store Charge Accounts:** A retail chain in the Southwest recently discontinued its selective in-house charge account system in favor of accepting two of the national credit cards. The decision was made after management learned that its banks were willing to make loans secured by accounts receivable charged to the national cards.

#16 **Precautions Against Forgery:** An associate professor in business administration recommends the following precautions against check forgery:

- identify each check cashing customer with the following identification: driver's license; unexpired credit cards; store courtesy card. Do not accept: social security card; library card; union membership card; employee ID badges without photos; student ID cards without photos.
- #17 examine the back of the check for some indentation made in writing the instrument. If there is no indentation, the check may have been counterfeited by photo-offset printing.
- #18 insure that amount specified in figures matches the amount in writing. If it does not, the controlling line is the amount specified in writing.
- #19 do not cash or accept second party checks.
- #20 do not provide counter checks.

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#21 · consider introducing the "Indicator" at checkout counters. The "Indicator" is a recent development in security technology allowing a sophisticated copier to photograph the fingerprints left by customers on their checks. No ink is required.

#22 · find corporate co-makers for customers' checks. Certain corporations and credit institutions will guarantee the checks of their customers in the case of default. The guarantee service is provided for a fee.

#23 **Precaution Against Bouncing:** A New York retailer has installed an on-line computer bank terminal in three of his five stores. The terminals allow cashiers to run a quick check on the balance of any customer seeking to cash a personal check. Only customers of participating banks are granted check cashing privileges.

Credit Card Management

#24 **Discourage Credit Card Use:** Determined to reduce its accounts receivable, a Washington, D.C. bookstore instituted two policies to discourage the use of credit cards:

- each store introduced a fast-service checkout line for the exclusive use of cash customers. Store managers were directed to "keep that cash line moving."

#25
- management established a minimum purchase level for the use of credit cards. The bookstore clientele did complain; they also accepted the policy and paid cash.

#26 **Farm Out Credit Card Management:** In 1977, J.C. Penney lost $16 million on its $3.6 billion credit card program. With such retail goliaths suffering credit card losses, it is not surprising that firms of all sizes are contracting for the management of their private credit card services. Professional management by the country's leading credit institutions offers three advantages:

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1) professional managers can convert receivables into cash more quickly allowing an improved cash position.

2) as professional managers introduce increased use of computer services, bad debt losses are reduced.

3) economies of scale permit outside firms to provide credit card management services at a cost lower than that incurred by the store's own program.

Inventory Management

#27 **Stock According to Profitability:** In the spring of 1980, the president of an interstate retail chain decided to reduce total inventory by 10%. Store managers were directed to assign a grade to each product according to its contribution to corporate profits. Grade "A" items, those with the highest profit contribution, were stocked in sufficient quantity to ensure 100% service. By contrast, grade "C" items were stocked for 70% service only. Inventory reductions under the firm's new grading system will total $5 million this year.

#28 **Discriminate Against Slow Items:** After discovering that 20% of its products accounted for 80% of its sales, a national drugstore chain instituted three policies to reduce inventory levels by $1 million:

- first, the chain redesigned its departments to allocate the best shelf space to the fastest selling products.

#29
- second, the stores discontinued the purchase of products whose sales fell below a certain, fatal level. The discontinuation was automatic.

#30
- third, the chain management calculated its average sales volume per square foot of shelf space in the stores. Products whose sales per square foot fell grossly below the chain average, here $150 per square foot, became prime candidates for replacement.

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#31 Color-Code Product Labels: A New York pharmacy co-op plans to introduce color-coded product labels to help store managers determine the month in which the product was purchased. Products displaying colors used in early months will be discontinued.

#32 Purge Slow-Moving Products: Writing for an industry trade journal, the president of a New York retail chain listed three rules for purging slow moving products from a store's shelves:

- develop a monthly schedule for returning inventory items to their manufacturers. Each month target a new set of suppliers who will receive excess inventory in their product lines. Follow the schedule without deviation.
- never introduce a new product into inventory without first purging another product from stock.
- monitor fad purchasing with some suspicion. When demand begins to soften for "hot items," cut back on inventory.

#33 Display Fewer Expensive Goods: High priced products require high carrying costs. A Washington, D.C. retailer recommends, therefore, that store managers cut back on their display of expensive goods. For example, the shelf space allotted to watches and jewelry in a department store should be reduced as carrying costs increase.

#34 Master Industry Rules of Thumb: Most large retail industries have developed rules of thumb for the levels of inventory to be maintained in different product lines. Small business managers should master the rules developed by the more sophisticated industry leaders. For example, one drugstore consultant offers three maxims for his clients:

- stock one month's inventory in the best selling 100 drugs.
- #35 reduce quantity buying in the next 400 best selling drugs.

#36		• stock only enough for one large prescription in the slowest selling drugs.

Purchasing

#37	Reduce Direct Buying:	A New York chain store owner recommends fewer direct purchases from the manufacturers of products and more purchases from the large wholesalers. Returning products to each of the several hundred manufacturers can be an administrative nightmare; returning products to a handful of wholesalers is, by comparison, quite simple. Further, many manufacturers require a minimum order quantity which unnecessarily inflates inventories. Finally, the burdens of inventory control often can be shifted to the wholesaler. One drugstore owner requires, as a condition for purchase, that its wholesalers offer electronic inventory control and periodic product movement reports.
#38	Establish Dollar Buying Limits:	A systems consultant advises his larger retail clients to establish budget ceilings for the purchases of each department manager. The ceilings should be set according to the state of the general economy. For example, if last year's healthy economy justified $5000 in cosmetics purchasing, this year's budget might be set at $4500.
#39	Establish Purchasing Goals:	Until the credit crunch of 1980, the purchasing managers of an established retail chain were evaluated only on the sales of their product lines. In the last five months, however, the firm has set inventory goals for each purchaser; bonuses and promotions may one day be based on inventory performance.
#40	Reduce Expansion Purchasing:	The nation's fastest growing bookstore chain recommends stocking new stores from the excess inventory of existing units. The same transfer practice may be adopted to balance inventory and reduce overall stock levels among the established outlets.

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#41 Expedite Purchasing Process: Alarmed with its burdensome cost of borrowing, an East Coast home products retailer decided to reduce its inventories. The chain established a freight-expediting office whose sole purpose was to work with suppliers in finding quicker means to deliver ordered products. Each day cut from the delivery time allows the reduction of one day's worth of goods in inventory.

#42 Encourage Surrogate Purchasing: An inventory managers' trade journal recommends that small businesses allow larger firms to order any raw materials needed for production. In particular, the small business manager should encourage his more substantial corporate customers to assist in negotiating volume discounts. The resulting savings can be shared by the small business manufacturer and his big firm buyers.

II) Cash from External Sources

A November, 1979 article on corporate financing in the United States reports on the increasing dependence of small business on bank borrowings and alternative sources of debt. The table below, summarizing the report findings, shows that 53% of the capital held by small firms derives from debt sources.

Capital Structure of Small Business

Source of Funds	% of Total Capital	
Local bank loans	33%	
SBA loans	9%	
City bank loans	3%	
Industrial aid bonds	1%	
Other debt	6%	
Subtotal		52%
Equity		48%
Total		100%

Ray G. Jones, Jr., "Analyzing Initial and Growth Financing for Small Business," Management Accounting, November, 1979, p. 31.

Recognizing the increasing dependence on debt, there should be little surprise at the alarm voiced by small business managers over the recent hike in interest rates from 9 3/4% to 20%. More alarming still is the fact that, for some small businesses, bank loans may not be available at any price.

The section that follows offers 13 ideas on alternative sources of cash for small firms unable to borrow from commercial banks. The section closes with a list of criteria a bank loan officer might apply to a small business which does decide to seek bank funding.

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Sources of Debt Financing

#43	Fortune 500 Corporations:	Even the least schooled and sophisticated financial manager knows of the temporary cash flow benefit realized in postponing payments to creditors. What may be less well known is that many of the larger corporations will extend general purpose loans as well as trade credit to their small business customers. More generally, many of the nation's corporate giants have established financial subsidiaries whose sole purpose is to provide venture capital and management assistance to small business. A leading computer corporation plans to introduce 400 small business loan offices in the United States. The company already provides office space, secretarial services, photocopying, management consulting, financial consulting, personnel consulting and computer hardware and software for its existing and potential small business clientele.
#44	Loans from Clients & Suppliers:	A leading small business textbook argues that a small business owner's professional associates may prove to be self-interested benefactors. For example, an out-of-town manufacturer may finance the operations of a local distributor. Similarly, a shopping center developer may provide working capital to his first business tenants.
#45	Public Bond Markets:	Until recent years, a list of Wall Street's publicly traded bonds read like a roll call for the Fortune 500. Within the last four years, however, the amount of public debt issued on Wall Street by small and moderate sized firms has increased 8000%. In May of 1979, for example, a New York investment bank assisted a North American watch distributor with sales of $26 million issue a $14 million public bond. The interest rate assigned to the debenture was 2½ points below the rate offered by a commercial bank.

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#46 **Eurodollar Debt Market:** Like its U.S. counterpart, the Eurodollar debt market allows small, moderate and large firms to raise U.S. dollars in public debt trading. For example, a New York investment bank recently assisted a small Texas-based manufacturer to raise $20 million in the Eurodollar market. The advantages offered by the European market were twofold: first, the interest rate was substantially below that charged in the U.S.; and, second, the entire offering was structured in a fraction of the time required for SEC approval in the U.S.

#47 **Small Business Investment Company:** As of September, 1979, over 300 small business investment companies (SBIC's) had been charged with the single responsibility of providing venture capital and management assistance to small businesses. An SBIC is a privately owned investment company whose shareholders receive privileged tax treatment as an inducement to assist small business. Because of the favorable treatment and the availability of government secured funds, an SBIC is able to risk loans which most commercial banks might deny. A free directory to the nation's 300 SBIC's is available through:

National Association of SBIC's
618 Washington Building
Washington, D.C. 20005
202-638-3411

#48 **State Business Development Corp.:** In the spring of 1975, a New York apparels plant served notice on its 150 workers that operations would be shut down within 60 days. The plant management had concluded that it would be unable to raise the required half million dollars to fend off bankruptcy. Within 30 days, however, the New York Development Corporation had structured a $580,000 loan package to rescue the firm.

The New York Business Development Corporation is one of 28 state chartered institutions organized throughout the country to stimulate business and employment. Relying heavily on government loan guarantees, the development corporations are able to grant loans which many commercial banks are not able to match.

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Sources of Equity Financing

#49 Partnership for Equipment Purchase: A Southwest drilling company recognized that its equipment loan application would not stir much interest in the local banking community. The firm was proposing to purchase $33 million of equipment on an equity base barely 60% that size.

Before submitting its bank application, the drilling company decided to raise additional equity capital without diluting its present stock. The firm organized a subsidiary corporation to purchase the equipment. The subsidiary, a 10 year partnership, raised $2.3 million from the parent company and $6.5 million from a team of limited partners. The resulting $9 million provided a sufficient downpayment to convince a commercial bank to loan the remaining $24 million.

The company leased the equipment from its partnership subsidiary, thereby gaining use of a machine whose direct purchase had proved impossible. The limited partners benefited both from a stream of lease payments and depreciation deductions.

#50 Partnership for R & D Expenses: A national accounting firm has advised two clients on an equity capital source very similar to that structured for the Southwest drilling company discussed above. The parent firms were directed to establish limited partnerships to raise funds needed for corporate research.

The parent companies purchased the rights to any commercial development of the research findings. The limited partners were allowed a 70% deduction on their partnership contributions and benefited from purchase payments made by the parent firms.

#51 Employee Stock Option Plans: Under existing U.S. tax law, an employee stock option plan (ESOP) can both provide immediate cash to a small business and create a retirement benefit for the firm's employees. The small business contributes unissued stock to an employee retirement fund. Like any other business expense, the contribution is tax deductible. In addition, the deduction can be carried back against income in more profitable years to create an immediate tax reimbursement.

As the employee stock option plan requires sophisticated tax planning and may involve a serious long run cost to the firm, professional counsel is recommended.

#52 Employee Convertible Debentures: As an alternative to the employee stock option plan, one business consultant recommends the adoption of employee convertible debentures. Under this second proposal, employees would be given the option to loan personal funds at a competitive interest rate to the small business. As an incentive to encourage employee loans, these funds could be converted at the option of the employee to stocks in the company, should company growth and profit make conversion attractive.

Non-Traditional Funding Sources

#53 Sale of Unused Marketing Rights: A small microcomputer company in California required additional capital to cover its growing product inventories. After the firm's banker denied a loan application, the company founder raised funds by selling the Australian marketing rights for his products. The California firm's opportunity cost was marginal; the company had not planned a marketing campaign for Australia anyway.

#54 Social Security Administration: The Social Security Act of 1937 and subsequent revisions states that the worker's share of Social Security taxes is not subject to taxation if paid, rather than merely withheld, by the employer. A hospital in North Carolina found that by taking advantage or this provision it could reduce its overall payroll costs substantially. In addition, the savings generated under this plan made it possible to increase employee's take-home pay. The hospital, whose payroll costs were $6.2 million in 1978, projects savings of more than $1 million in the 10 years from 1978 to 1987.

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#55 Rent Out Factory and Employees: According to one small business periodical, some firms suffering from underutilization are renting out their plants and employees. The underutilized firm faces two choices. Either it can accept contract work to be performed in its own facilities or, in the exceptional case, it can rent out the use of its employees for outside services.

Criteria Applied to Small Business Loan Applications

Small business managers who do decide to seek commercial bank financing should know the criteria applied to their loan applications. A rank ordering of the factors affecting the extension of credit to small business is provided below. The factors were selected in a 1975 survey of 124 banks.

Factors Affecting Extension of Credit to Small Business

Rank	Factors
Great Importance	
1	Quality of management
2	Risk of default
3	Size of loan relative to size of business
4	Firm's debt to equity ratio
5	Intended purpose of loan
6	Firm's liquidity position
Moderate Importance	
7	Type of repayment plan
8	Type of collateral available
9	Past trend of firm's profit
10	Future trend of firm's profit
11	Stability of net profits
12	Ease with which the firm's assets could be sold in case of liquidation
13	Existence of possible future profitable relations with the firm
14	Information on previous loans
15	Loan activity at other banks
16	Maturity of loan requested (short term vs long term)
17	Availability of certified financial statements

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Rank	Factors
18	Length of time doing business with your bank
19	Expected size of deposit balances with your bank
20	Rate of return the firm earns on its assets
21	Availability of interim financial statements
22	Length of time the firm has been in business
23	Type of business activity engaged in by firm
Slight Importance	
24	Contribution to community welfare
25	Level of firm's account activity
26	Other investment opportunities available to your bank
27	Availability of cash budget
28	Cost of monitoring loan
29	Government guaranty of loan
No Importance	
30	Cost of implementing loan (e.g., credit checks, legal fees)

Herbert S. Cassel and Thomas A. Ulrich, "Factors Influencing the Extension of Bank Credit to Small Businesses," Journal of Small Business Management, April, 1975, pp. 30-31.

III) Federal Government Assistance Programs

Over 150 departments, agencies, regional and field offices of the U.S. Federal Government are organized to provide financial and management assistance to the business community. Some of the programs of greatest interest to small business are listed below:

U.S. Small Business Administration

The SBA offers a variety of lending programs and management counseling services. A brief description of these programs is provided below. For further information, contact the SBA Office of Programs at 202-653-6787 or one of the 63 SBA field offices nearest you.

Regular Business Loans

financial assistance provided to specified categories of small business either in the form of direct government loans or government guarantees of private commercial loans.

Economic Opportunity Loans

loans to the socially and economically disadvantaged. Prospective and established small firms are eligible.

Local Development Company Loans

loans made to groups of local citizens investing in community economic improvement projects.

Pool Loans

loans made to groups of companies for their combined purchase of raw materials.

Revolving Line of Credit Guarantees

guarantees of credit extended by banks to fulfill construction or other contracts.

Displaced Business Loans

loans to help relocate or re-establish small firms injured by government renewal or other construction projects.

Handicapped Assistance Loans

assistance to small business owners who operate in the interest of the physically handicapped.

Natural Disaster Loans

Physical Damage - loans to repair or replace damaged or destroyed property

Economic Injury - loans for working capital and funds to pay financial obligations

Product Disaster Loans

Assistance to firms unable to process or market a product for human consumption due to natural or undetermined causes.

Base Closing Economic Injury Loans

loans to help a small business survive or re-establish itself in the wake of a closing or severe reduction in size of a major military installation.

Strategic Arms Economic Injury Loans

loans to companies negatively affected by an international agreement limiting the development of strategic arms and facilities.

Emergency Energy Shortage Loans

loans to assist small businesses suffering economic injury as a direct result of energy-related shortages.

Regulatory Economic Injury Loans

assistance to firms which require substantial changes in equipment and operations in order to comply with governmental regulations.

Pollution Control Financing Guarantees

100% guarantees of payments due under qualified contracts for the planning, design, financing or installation of pollution controls by eligible small businesses. Long-term (20-30 years) low interest financing made available in the bond market.

Surety Bonds

guarantees to qualified sureties up to 90% of losses incurred under bonds issued to contractors.

Management Counseling

management assistance provided nationwide by the SBA on three levels: SBA Management Assistance Staff, Service Corps of Retired Executives/ Active Corps of Executives (SCORE/ACE), and numerous national professional association volunteers.

Small Business Institute

three-way coalition between collegiate schools of business, members of the nation's small business community, and the SBA supplying on-site management counseling.

Call Contracting Program

SBA referral to professional consulting firms who will provide management and technical assistance for a nominal fee.

Courses, Conferences, Clinics and Training

numerous programs offered to assist and advise the small business owner on matters ranging from internal management practices and techniques to international trade.

Advocacy Office Task Force

To supplement the financial and management assistance programs discussed above, the SBA Office of Advocacy has established a Task Force for Economic Stability to help small business firms weather the current economic downturn. The Task Force will serve as the representative of small business interests in meeting with banks, lending institutions, professional firms and associations. In particular, the Task Force will:

1) encourage banks and other lending institutions to take practical steps to help maintain adequate cash and credit flows;

2) encourage lawyers, accountants, management consultants, and their professional societies to act on an organized volunteer basis to help maintain stability and prosperity;

3) encourage trade and professional associations, small business groups and Chambers of Commerce to inform their members of special Federal Government efforts to assist small business;

4) communicate accurate, specific, detailed and timely information on small business problems to the responsible Federal officials.

U.S. Department of Commerce

International Trade Administration

The ITA section of the Commerce Department offers a variety of services to small business owners in their overseas marketing endeavors. For further information concerning the sampling of programs provided below, contact one of the 47 Commerce Department district offices throughout the U.S. or call the Deputy Assistant Secretary for Export Development at 202-377-5261.

New Product Information Service

data translated into several languages and disseminated throughout the world when submitted by a company interested in selling a new product abroad.

World Traders Data Reports

provide descriptive trade profiles on specific foreign firms, including credit sources and financial and commercial data.

Agent/Distributor Service

assists in identification of potential foreign agents or distributors interested in U.S. business supplier.

Trade Opportunities Program

furnishes U.S. business firms with detailed opportunities for direct sales

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to overseas buyers and notices of foreign companies offering to represent U.S. firms abroad.

Export Mailing List Service

offers business firms lists of foreign organizations for export contract purposes.

Product Marketing Service

offers U.S. business executives traveling abroad, for a modest fee, the use of the Commerce Department's U.S. Trade and International Marketing Centers as a temporary base of operations. Office space, secretarial and translation services and assistance in locating business prospects included.

Economic Development Administration

Business Development Assistance Loans

financial assistance through long-term loans and guarantees which exceed $500,000 for economic redevelopment in areas of substantial unemployment or low median family incomes.

Trade Adjustment Assistance Loans

loans up to $1 million and guarantees up to $3 million to assist firms adversely affected by imports.

For further information, contact Mr. Glenn Waldron, Director, Office of Development Finance Projects at 202-377-5236 or call the nearest Department of Commerce district office.

U.S. Department of Agriculture

The Farmers Home Administration Business and Industry Loan Program provides up to 90% loan guarantees to businesses to spur economic development in rural communities with populations of 50,000 or less.

For further information, contact Mr. Robert E. Butler, Assistant Administrator for Business and Industry at 202-447-5343.

U.S. Department of Labor

On the Job Training Program

Employers who hire and train personnel through Department of Labor-sponsored programs may be eligible for reimbursement of costs paid during the training program.

For further information, contact Mr. John Stetson, Director, Division of Private Sector Initiatives at 202-376-7633.

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Mine Safety and Health Compliance Assistance Visits

Owners of new or newly opened intermittent mines may receive advisory inspections on request. Owners are advised of violations, but no citations are issued.

For further information, contact Mr. Wayne Veneman, Chief, Office of Information at 202-235-1452.

Women in Business Program

Technical and other assistance is made available to those women already in small businesses or entering the job market.

For further information, contact Ms. Paula Greenfield, Special Assistant to Director, Women's Bureau at 202-523-6611.

Technical Assistance Program on Pension and Benefits

Assistance is available to small businesses to reduce administrative burdens and qualify for exemptions from certain reporting requirements under ERISA.

For further information, contact Mr. Ellis Rottman, Information Officer at 202-523-7408.

U.S. Postal Service

Customer Service Representatives of the U.S. Postal Service counsel small business owners throughout the country on the means to obtain the most for their postage dollars, how to set up mailrooms and resolve miscellaneous mail problems.

For further information, contact the Consumer Advocate's Office at 202-245-4514 or check with a local post office.

Federal Emergency Management Agency

The Federal Insurance Administration of FEMA assures that businesses may be insured against floods, crime and riots. Insurance programs for each are detailed below:

National Flood Insurance Program

makes flood insurance available to property owners at reasonable costs, in return for which communities are required to carry out flood plain management measures to protect lives and reduce property loss.

For further information, call 800-424-8872.

Federal Crime Insurance Program

enables residents and businesses to purchase affordable insurance against burgulary and robbery losses in eligible states.

For further information, call 800-638-8780.

Urban Property and Riot Reinsurance

reinsures the general property insurance business against riots. It is available to insurance companies in states with state-wide plans for fair access to insurance requirements (FAIR) plans. Property owners are provided access to fire, extended coverage and vandalism and malicious-mischief insurance.

For further information, call 202-755-6555.

Overseas Private Investment Corporation

OPIC loans small businesses up to $5 million or guarantees commercial loans up to $50 million for foreign investment projects. Risk insurance against currency inconvertibility, nationalization or war, and standard commercial insurance are provided as well.

For further information, call 800-424-5201.

Export-Import Bank of the United States

The Ex-Im Bank provides guarantees directly to U.S. firms covering commercial and political risks involved in the performance of services abroad and in the leasing, consignment, or exhibition of U.S. goods in foreign markets. Counseling is provided through a series of conference programs held regularly throughout the United States. The Bank also maintains a Small Business Advisory Service to assist firms in the use of export credit insurance, guarantees, discount loans, and foreign bank credits.

For further information, call the Small Business Advisory Service in Washington at 202-566-8187.

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IV) Bibliography

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Summary Checklist

A checklist summarizing the leading ideas and recommendations detailed in this publication is provided below. This list can be used by small business managers in determining which proposals apply to their firms and warrant more serious study.

	Leading Recommendations	Applicable	Not Applicable
	Accounts Payable		
#1	Use domestic letters of credit.	____	____
#2	Direct suppliers to submit bills following monthly peak of receipts.	____	____
#3	Do not pay bills before discount date.	____	____
#4	Negotiate installment payment plan with suppliers.	____	____
#5	Establish third party payor to make disbursements to suppliers.	____	____
	Accounts Receivable		
#6	Factor receivables.	____	____
#7	Use incentives to encourage salesmen to keep accounts current.	____	____
#8	Enclose a stamped, self-addressed envelope with bills	____	____
#9	Use "Tickler Method."	____	____
#10	Hire part-time credit manager.	____	____
#11	Collect unearned discounts.	____	____
#12	Calculate tax savings on debt before hiring agency for collection of receivables.	____	____
	Cash Management		
#13	Barter goods and services with other firms.	____	____
#14	Use surplus cash to make short-term investments.	____	____
	Charge Account and Check Management		
#15	Discontinue store charge accounts.	____	____
#16	Use secure I.D. only.	____	____
#17	Examine back of check for indentation in writing.	____	____
#18	Insure that amount specified in figures matches amount in writing.	____	____
#19	Do not accept second party checks.	____	____
#20	Do not provide counter checks.	____	____
#21	Introduce the "Indicator."	____	____
#22	Find corporate co-makers to guarantee checks.	____	____
#23	Install computer bank to check customer balances.	____	____

	Leading Recommendations	Applicable	Not Applicable
	Credit Card Management		
#24	Introduce fast-service check out line for cash customers.	______	______
#25	Establish minimum purchase level for use of credit cards.	______	______
#26	Farm out credit card management.	______	______
	Inventory Management		
#27	Stock according to profitability.	______	______
#28	Allocate best shelf space to fastest selling products.	______	______
#29	Discontinue purchase of items with low sales volume.	______	______
#30	Judge private sales against company-wide average.	______	______
#31	Use color-coded product labels to indicate age of inventory.	______	______
#32	Monitor fad purchasing.	______	______
#33	Display fewer expensive goods.	______	______
#34	Stock minimum level of best selling 100 products.	______	______
#35	Reduce quantity buying.	______	______
#36	Stock one order size only of slowest selling products.	______	______
	Purchasing		
#37	Increase purchases from wholesalers.	______	______
#38	Establish ceiling budgets for purchases.	______	______
#39	Set inventory goals for purchasers.	______	______
#40	Stock new stores from excess inventory.	______	______
#41	Expedite purchasing process.	______	______
#42	Surrogate purchasing	______	______
	Sources of Debt Financing		
#43	Large corporations and their financial subsidiaries	______	______
#44	Clients and suppliers	______	______
#45	Public bond markets	______	______
#46	Eurodollar debt market	______	______
#47	Small Business Investment Companies	______	______
#48	State Business Development Corporations	______	______
	Sources of Equity Financing		
#49	Partnership for equipment purchase	______	______
#50	Partnership for R & D expenses	______	______
#51	Employee Stock Option Plan	______	______
#52	Employee Convertible Debentures	______	______
#53	Sale of Unused Marketing Rights	______	______
	Nontraditional Funding Sources		
#54	Social Security Administration	______	______
#55	Renting out factories and employees	______	______

Comments, suggestions or requests for additional copies of this draft report, should be directed to:

Milton D. Stewart
Chief Counsel for Advocacy
U.S. Small Business Administration
1441 L Street, N.W., Room 1010
Washington, D.C. 20416

APPENDIX 4

SMALL BUSINESS MANAGEMENT SERIES
HOW TO WEATHER THE CURRENT ECONOMIC STORM

This morning's workshop is designed to orient small business to the problems of our current economy. Reassessment of business practices and sharpening of management skills are the keys that many of the small business persons in Chautauqua County will be paying closer attention to in 1980.

This seminar is not intended as a cure all but more of a forum for awareness of the various problems of staying in business and the alternatives available to those who find it impossible to do so.

May 12, 1980 - Hall R. Clothier Auditorium - Mayville, New York
8:30 A.M. — 1:00 P.M.
Registration Fee is $5.00 - this includes all materials and refreshments.
Registration fee is non-refundable.

8:36 A.M.
Registration - Coffee

9:01 A.M.
Statement from County Executive Joseph Gerace
Welcome - C. Ronald Vahl
"It's Easy to Fail - I Know!"

9:16 A.M.
Do You Control Your Inventory or Does It Control YOU?
Paul Sandburg - President of Carnahans in Jamestown - Former Bank Vice-President

9:59 A.M.
The Two Minute Stretch

10:01 A.M.
Michael Jamesson - Vice-President of First Trust Union Bank, Wellsville, New York
A Cuba, New York native. Mike graduated from Yale University in 1975 with a degree in Economics
and has been with First Trust Union as an economist since graduation.
Present Economic Condition and a 12 month forecast based on Economic Indicators is this section topic.

10:46 A.M.
Coffee Break

11:02 A.M.
Financial Management in Today's Economy
Preston Drayer - Buffalo S.B.A. Management Assistance Officer
Tighter Management Control as opposed to borrowing

11:27 A.M.
Financing in Today's Economy
Harold (Skip) Dye - Buffalo S.B.A. Loan Officer
If borrowing is the only answer, here's how!

11:51 A.M.
Liquidate - Is it a viable alternative to bankruptcy.
Ward W. Westerberg - Attorney with Johnson, Peterson, Tener and Anderson

12:36 P.M.
Questions and Answers

APPENDIX 5

SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

Date: OCT 2 1979

Reply to Attn of: PPB

Subject: Assisting Small Business during the Upcoming Economic Slowdown

To: Regional Administrators
District Directors

As you probably know, economic forecasters are predicting a period of very slow growth during the remainder of the year. It is SBA's policy to provide to the small business community maximum cooperation and support during periods of economic stress. The purpose of this memo is outline steps that SBA can take to help small business particularly SBA clients, survive these uncertain economic times.

1. Field managers should anticipate a higher than normal number of requests for payment relief and for release of collateral. Liberal use of the available remedies such as deferments, moratoriums, payment reductions, etc., should be encouraged.

   Communication with banks (whether telephone conversation, bank newsletter, etc.) should remind bankers of these means of payment relief and inform them that SBA will be responsive to requests for these actions. Responses should be formulated in advance, as much as possible, in order to allow SBA to react quickly.

   Banks should be encouraged to concentrate on lending to existing firms as opposed to new starts. Banks which do not participate or participate to a limited degree should be advised that they can maintain service to their small business borrowers who need help during the slowdown by using the guaranty program. To alleviate any problems a bank may have about yields, banks should be educated about our variable rates and encouraged to use it.

   Now may also be an opportune time to remind banks of the Secondary Market and the cash generation possibilities available by selling loans. The sale of SBA loans can help offset the liquidity crunch usually experienced by banks during an economic slowdown.

2. Loan officers should contact banks that have approved but undisbursed loans and encourage the banks to proceed with disbursement as quickly as possible. Direct loans should also be rapidly disbursed.

Finance personnel should concentrate efforts on existing firms with emphasis on current SBA borrowers.

3. Management assistance personnel should concentrate their efforts on existing businesses rather than encouraging the formation of new businesses. This effort should place primary importance on assisting current SBA clients.

4. Surety bond recipients should be monitored closely because of the proportionately greater burden suffered by firms in industries where surety bonds are a necessary part of operation. Field offices should be ready to arrange a loan or provide management assistance to these firms.

5. Regional Administrators and District Directors should be especially sensitive to problems that may be limited to their particular geographic area. Plans should be developed by Regional or District Management to help address these problems.

6. A special effort should be made to protect minority businesses and women owned businesses in your local area. Further, loan assistance, management assistance, and procurement assistance should be utilized to the fullest extent possible to protect the gains made by these groups in the past couple of years.

7. Procurement assistance should be used to provide small firms with an access to government purchasing. The government sales can be used to replace sales lost due to the economic slowdown. The PASS system should be a valuable tool in meeting this goal. Extra effort should be made to encourage prime contractors to utilize SBA when selecting subcontractors for large jobs.

8. The 8(a) firms should be closely monitored in order to immediately determine any potential problem areas and develop alternative courses of action to deal with these problems.

To provide information on the condition of small business, Regional Administrators are requested to provide a report to the Office of Finance and Investment through the Office of Field Management on or before the tenth of each month in narrative form indicating the economic situation in the region as related to small business and the efforts made by the region to implement the policy in this memorandum.

I know you all will do everything in your power to help small business survive the coming period of economic uncertainty. Hopefully, by deferring loan payments or providing management assistance, SBA can prevent the layoff of the employees of our clients and help these businesses remain viable. I am confident that all SBA employees will do everything possible to help the small business community through this difficult time.

A. Vernon Weaver
Administrator

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

November 26, 1979

Dear Bank Chief Executive:

Recent initiatives by the Federal Reserve Board to reduce inflationary expectations and harness growth of the money supply are expected to cause temporary disruptions and a period of readjustment for the small business sector of our economy.

The Small Business Administration strongly urges special efforts by your bank to help small firms with their credit needs during this period of adjustment, and SBA is prepared to help you in this effort. We expect that small business will be faced with a three-fold problem related to credit — limited availability, increased competition for what credit is available and the unusually high cost of credit.

I have instructed my field offices to work closely with local banks in their communities to assist existing SBA portfolio companies in every possible way, including the liberal use of deferments, moratoriums and payment reductions. And certainly, in many cases small firms should be encouraged to conserve their capital, to postpone certain external financing plans and to improve their management of cash flows and inventories.

Where credit is needed, we believe several of SBA's recent initiatives related to our guaranty bank loan program will assist you in extending credit to small firms. Our increased loan guaranty authority (which is now at $3.3 billion) and improvements in our secondary market system will give banks needed liquidity to help keep the flow of capital available. Our variable rate and the pending change to pass through the guaranty fee should remove any pricing impediments to your bank's participation. And, recent changes in our outside assets and personal guaranty policies make the program more compatible with your conventional lending practices.

Chairman Volcker has encouraged commercial banks to continue to extend needed credit for "productive" purposes, and he has specifically indicated that sound small firms are a "productive" category of the economy that should be given special consideration. Small business is responsible for a large share of the innovation, employment and competition within our economic system, and a vibrant small business community is essential to a long-range solution to our inflation problems.

We appreciate your help in this vital effort.

Sincerely,

A. Vernon Weaver

A. Vernon Weaver
Administrator

DRAFT **DRAFT** **DRAFT**

APPENDIX 6

Dear __________:

This is a particularly trying time for small business. Efforts to restrain inflation are continuing, even while serious downturns mark significant parts of the small business economy.

Because of its narrow equity base, the small business sector must rely on debt to finance many functions for which large companies can use equity. This makes small business particularly vulnerable to rising interest rates.

It is our hope that every Federal procurement agency can do as much as the law and prudent management permit to help small business maintain its cash flow.

To the extend that your policies and procedures permit flexibility, we hope you will find it possible to pay your small business suppliers and contractors first and fastest. Many large companies in the private sector have learned that this is a necessary part of responsible management in a period like the one we are in.

Where your policies and procedures do not permit this "first and fastest" payment, we will be happy to discuss appropriate means of changing them with you.

Very truly yours,

MDS

Mr. STEWART. Thank you, Mr. Chairman.

We agree with you that we are talking about a beginning.

In the statement we have submitted for the record, we emphasize some of the problems that we face in developing a strategy for small business. The critical problem is absence of a small business data base. Our present estimate is that within 2 or 3 years we will have much better information for use in discussing issues like the one before us.

The first element in the strategy which we want to talk about I would characterize as "bandaids and tourniquets." We must respond quickly to small business people who are confronted by a deepening recession and inflation.

Our strategy is to strengthen the survival capability of small business and try to help each small business person deal with his own cash flow difficulties.

There are three immediate problems most small businesses face in this present situation. First, a reduction of trade credit due to shorter time and lesser amounts allowed by suppliers; second, a demand for increased credit from their customers; and, third, an increase in cost and a decrease in availability of bank debt to support it.

Mr. LAFALCE. Is this in your statement?

Mr. STEWART. Yes. I am summarizing the statement.

Perhaps I should have explained that there is an initial summary in the statement which highlights the key elements of the strategy. Appendix 1 of our economic statement prepared by Dr. Robert Berney, our chief economist, who is here with me. It highlights the elements that are central to the problems of small business.

Cash flow problems are critical. There is a chart in our statement comparing small business dependency on debt and equity with that of large business. Small business is far more dependent on debt. This intensifies the cash flow problem since declines in debt availability occur just as needs are increasing.

One of the things we have done is to establish a task force on economic stability made up initially of 20 small business people. Some of them were before this committee when I was last here. We are drawing on their experiences to build knowledge of what individual business persons can do. Results of our first effort is in the appendix, a draft document entitled "Protecting the Small Business Cash Flow Lifeline." It describes 55 specific steps a small businessperson may find useful.

We have also initiated education programs. For example, in the appendix 4 you will find the announcement of a seminar entitled: "How to Weather the Current Economic Storm." This was part of a small business management series in Mayville, N.Y., initiated by SBA's Buffalo office. We hope to accelerate the education process with sessions like this around the country. Expanding the ability of small business persons to deal with these problems is a key step in our strategy. And we have tried to directly influence credit availability.

Appendix 5 includes letters which the Administrator sent to SBA field personnel and the Nation's banks last October when the Fed first tightened credit. These letters describe credit crunch expectations and ask SBA field personnel to focus on preserving existing small business rather than helping form new businesses.

The Administrator has also stated that loan payment deferments and moratoriums are available and should be used within the limits of the law and prudent debt management.

Another aspect of affecting credit availability is improving the ability of small business to deal with the financial community. When the small business community meets in an organized way with local banks—as they are now doing with Federal Reserve bank presidents for the first time across the country—small business problems are more likely to get the attention they need.

We are not alone in this effort.

For example, the Vice Chairman of the Federal Reserve Board appeared before you several weeks ago shortly after he met with our 20-member Task Force on Economic Stability. He heard their anecdotal accounts of bankruptcies in regions around the country, which is information that would normally appear only as numbers in Fed statistics. The process of bringing the experience of small business on a day-to-day basis to people in government, banks, and the financial community is one we hope this task force will facilitate.

Those of us who work for SBA in Washington talk daily with our regional and district administrators. I personally talk to our 10 regional advocates weekly, and try as best I can to insure that SBA policies are as supportive of small businesses' survival as the law and prudence permit.

The Federal Reserve is one example of how we are trying to encourage Federal agencies to help. We have drafted a letter to all procurement offices throughout the Federal system urging them to pay small business first and fastest. We may well send it to State and local governments too. We have explained that the extended payment periods that large suppliers can tolerate are disastrous for small firms.

Our long-term strategy is to expand small business bank credit by expanding the secondary market for SBA's guaranteed loans. We are also expanding the number of banks in the bank certification program.

These steps are the fastest and simplest way to help small business gain increased credit because it is bank credit that small business relies on.

We are open to suggestions for further help. We designed the task force to expand and become a mechanism to produce information on small business distress. We need other sources because the available Government data are of little help to us in assessing distress. I am talking now about the federally collected data from the backbone agencies—Treasury, Census, BLS, OASI, et cetera.

Indicators that are most helpful in assessing small business distress are bankruptcy information, tax foreclosure information, and other which the Federal Government collects on a slower basis than desired.

We also hope this task force will identify where Federal policies are hurting small business. Each member of the task force is an experienced small business person, usually a community opinion leader, who dealt with cash flow problems in his own business. We are recruiting them from among the White House Conference delegates and trade associations.

We are encouraging trade associations to improve support of their own small business members by drawing upon SBA resources. In many cases, they do a brilliant job but our SCORE and ACE people should be able to help even more.

The long range problem of inflation is examined in Dr. Berney's paper. Let me emphasize that these charts are preliminary. They are constructed from imperfect data.

The only reliable numbers we have are share of gross domestic product in 1963 and 1972. The remaining years are extrapolated from those 2 years. Such data extrapolation is risky but necessary to adequately display economic trends.

We have put these charts together to identify the long-term problems. Examine the relative growth of large and small business over the 10 years of 1963 through 1972 as shown in table 6. Large business clearly has a growing share while small business has a declining share.

If you project the growth rates of that 10-year period until the year 2000, large business will have 48 percent of the economy and small business will be down to only 32 percent.

The next chart (table) compares the largest businesses, about 250 of them which we call government-sized businesses, and the smallest businesses, those with under 20 employees. Members of this committee will recall that Dr. David Birch's research demonstrated that three out of every four jobs in this country are created by these smallest of firms, those with 20 or fewer employees. But their share of the economy, using those two benchmark years, is shrinking about 3 percent a year. The share of the largest 250 companies is going up by the same amount.

I want to reemphasize the preliminary nature of this data. But the results shown here are of sufficient magnitude to leave little doubt that the directions of movement are there, and we must plan and act to change the directions.

Such shifts in relative share of production have implications for inflation. Table 2, for example, shows the annual rates of change of prices for inputs used by small business. Item one is fuel and related products. The rate of change there is shattering; 59.5 percent last month and 47.2 last quarter with 55.6 percent last year. Also look at increases in the cost credit; 25.2 percent; the cost of capital of 52.7 percent, industrial commodities at 24.4 percent, raw materials at 24.3 percent, machinery and equipment at 13.7 percent, and payrolls between 7 and 9.5 percent.

This describes the relative importance of these inputs upon inflation within small business. For example, energy prices are far more important than wages. This example provides support for the wage price strategy that the administration has followed.

We have tried in this discussion to deal with core inflation as it is described in a recent report of the Joint Economic Committee prepared by Dr. Otto Eckstein. The distinction is made there between core inflation, the long-term inflation to which our economy has become subject, from shock elements like price increases of oil.

This committee had before it just recently the chief economist for the Department of Agriculture who gave you a staggering number on the cost of concentration in the food industry. We think that is of great importance in dealing with structural inflation. This is an inflation factor, long term, arising from changes in source of economic activity from small business to large business.

For a long time the most competitive and vigorous part of the economy has been small business. Government, States and local, on the one hand, and government-sized businesses on the other have eroded small business and competition.

Where small business abounds, markets are likely to be very competitive. New products are introduced and both price and technological competition are present. But within big business, especially very large business—government size—market competition is less likely to exist.

Referring to table 6, government's share of gross product originating increased 2 percent. Government-sized large businesses increased 2½ percent. Large business defined as 500 to 5,000 employees actually shrank slightly. Small businesses under 20 employees shrank 3 percent. Larger small firms, 20 to 500 employees, shrank only slightly—about half of a percent.

These shifts may appear small until you look at what happens if you project them over a 20-year period. You then see a squeeze effect between government and government-sized business shrinking small businesses' share, the most competitive and most vigorous sector of the economy. This, in my own view, is the unnoticed structural source of long-term secular inflation in this country.

Controlling government expenditures is essential if government's share of growth is to be stopped. It is also necessary to keep government-sized businesses from outgrowing small businesses competition inducing new products and new innovations come from small business. That is the key element in long-term strategy beyond the immediate recession inflation problems of small business.

On page 9 of my own statement I have identified three concepts which are the essence of this long-term problem.

First, the small sized business sector neither creates nor fuels inflation. It does not have the market power to do this. Instead it is a significant anti-inflation force because of its competitive vigor and because of its innovative product and process creativity.

Second, the small business is being crowded out of our economy by big business and big government.

Third, much of this crowding out by Government and government-sized businesses comes from government policies. We must address those policies as part of a strategy for small business survival and growth. The White House Conference delegates identified several troublesome policies. One example is taxation. In effect, small business cannot accumulate equity, or is not as attractive for equity, as big business because of Government tax policies.

A manufacturer in 1974 grossing under $500,000 had a cumulative tax burden—all the taxes paid, Federal, State, and local—equal to one-third of its net worth, the equity in the business. But, a manufacturer with gross sales of $5 million would have paid taxes to only 20 percent of net worth. For gross sales over a billion and a half dollars, taxes equaled 11.5 percent.

Such Government tax policy insures that big businesses can retain earnings better than small. And, if investors examine investing in large as against small businesses, they will choose to invest in large businesses. That, in effect, is what government is telling investors to do.

Capital gains taxes operate against small business investment as well. The tax rate is the same, whether the capital investment is in a small, new, high-technology company or an old well-established, dividend-paying, publicly owned company. Investor risk is very different, but capital gains tax treats them as equal.

Federal policy must begin to recognize that we do not have one private economic sector. We have two. They live differently. They finance differently. They manage differently. One, the big business sector, has resources abroad which are not available to small business. It copes with inflation in ways that small business does not have available to it. If its wages and prices go up, it has no trouble passing on increases in the marketplace because competition is limited. But if a small businessman is hit with cost increases, his ability to pass them on is limited because of a more competitive marketplace.

Federal policy has to adjust to this. This is why I supported for a long time a two-tier credit policy from the Federal Reserve Board.

We were delighted when the Fed provided $1 to $3 billion in seasonal credit for small farmers and small businesses because this action represented the first step the Fed took to deal with the special credit needs of the small business.

The points I have made here are relevant to strengthening U.S. small businesses in international markets.

We need to strengthen small business participation in world markets. The best estimates we have say that there are still at least 20,000 small firms that should be exporting and don't. If we can encourage these firms to export, we can improve our balance of payments position.

We have to start specifically targeting inflation cancers. For example, the price of oil is not subject to anything except political decision. It is based on what the supplier wants and nothing else. The price of oil will not come under competitive pressure from within the oil industry in our country or abroad. Oil prices will only come down as we develop alternative technologies and those are most likely to come from small entrepreneurial firms.

If we could tomorrow have a car which with one switch of your hand you could shift from being driven by gas to be driven by an electric-powered motor, a battery-powered motor, a solar-powered motor, the price of oil would come down pretty quick because you would have genuine competition which you cannot now have, given the distribution and the production structure in that industry.

I have summarized that view by saying that the only way we will ultimately liberate ourselves from overseas oil blackmail, or blackmail based on other scarce raw materials, because there are plenty students of OPEC around the world getting ready, is by a far more rapid rate of technological substitution than we have yet been able to achieve.

Mr. **Carter**. There is just one thing about the price of oil that I would like to ask. At the present time we are paying $40 to $42 a barrel for oil at Elk Hills and Teapot Dome. Yet, Saudi Arabia has been charging us only $26. They are making quite a profit. But it seems that our business people are too. Every time they see us bringing in our oil up, and I have heard it from them, they want to bring it up too. Am I correct in this?

Mr. **Stewart**. I believe you are, sir. I will inquire. As far as I know, you are correct.

What appears to us to be good for our domestic economy in a long-term anti-inflation strategy ought to be good for the whole world in dealing with inflationary elements because we all confront a situation where growth of multinationals and expansion of their share of world economy is matched by a growth of Government economies. The competitive small business sector is squeezed.

Once again, I do not say we know how to bring this about, either overnight or long term. The best thing for the people—not just for this country but of all the world—is to depoliticize decisionmaking; take it out of the hands of private monopolists and Government managers and build an international small business sector. And, until we learn how to do that, we are going to have secular inflation with us.

Thank you very much, Mr. Chairman.

Mr. LaFalce. Mr. Carter?

Mr. Carter. I want to thank Mr. Stewart for a good lesson in small business economics. I am grateful to him for it.

You mentioned the action of the Fed to help small business and the farmer. I believe you stated it was $1 to $3 billion. Is that correct?

Mr. Stewart. That was the estimate. Yes, sir.

Mr. Carter. What rate was this?

Mr. Stewart. I believe it was 13 percent, which was then the going discount rate.

Mr. Carter. It was 16 percent, but they have reduced that, if I remember correctly.

Mr. Stewart. Right.

Mr. Carter. The trouble to small business now comes from the Government itself and Government-sized businesses pushing into the small business sector.

It seems to me the tragic thing that you brought out here and which really hurts is the smaller the business is, beginning at $500,000, the more taxes one bears. That is really rough, as I see it. I think we should change our tax program. Do you agree?

Mr. Stewart. Absolutely, Mr. Carter.

I think it is fair to ask: Could we have had greater growth from small business relative to large businesses in this country if the overall cumulative tax rates had been what they were 30, 50, or 100 years ago?

Mr. Carter. At the present time we are lending money to various groups of people as low as 8.1 percent. Yet, for farmers and business people who would borrow this $1.3 billion which is to be provided, or has been provided, it will be at 13 percent. Don't you think that our small business people and our farmers should get just as good a break as Boeing, or Murdoch, or anyone else?

Mr. Stewart. I do not see any reason they should not, no, sir.

Mr. Carter. Then we would lower the interest rate to 8.1 percent, wouldn't we? I guess I shouldn't say that. You are a tremendously good man. You know your business.

Thank you, sir.

Mr. Stewart. Thank you.

Mr. LaFalce. Mr. Stewart, I did not get a copy of your statement until late this morning. I have not had an opportunity to read it. Then, when you summarized, departing from your text, I had difficulty——

Mr. Stewart. Mr. Chairman, let me just underscore that the difficulties you have are due to our shortcomings. There are tables which apparently have been left out of your copies.

Mr. LaFalce. It is not only the tables, but it is the prepared testimony that I did not have a chance to review. So, as I listened to you, I had difficulty answering the question in my mind of precisely what your strategy is right now to help small businesses get through this crisis.

[Tables referred to above follow:]

CORPORATE DEBT-EQUITY RATIOS FOR SELECTED INDUSTRIES FOR FIRMS WITH NET INCOME (BY ASSET CLASS, 1976)

	Asset classes										
	Under $25,000	$25,000 to $50,000	$50,000 to $100,000	$100,000 to $250,000	$250,000 to $500,000	$500,000 to $1,000,000	$1,000,000 to $2,500,000	$2,500,000 to $10,000,000	$10,000,000 to $25,000,000	$25,000,000 to $100,000,000	Over $100,000000
Manufacturing	2.99	1.36	0.94	0.72	0.59	0.59	0.51	0.45	0.40	0.45	0.57
Services	1.07	.72	.91	.85	1.18	1.74	2.11	2.07	1.39	1.14	1.25
Construction	3.00	1.25	1.35	.92	.98	1.13	1.11	1.21	1.24	1.08	78
Transportation	1.04	1.22	1.18	1.21	1.03	1.11	1.25	1.20	.96	1.17	.99
Wholesale and retail trade	2.52	1.06	.77	.76	.79	.91	.90	.91	.79	.73	.72

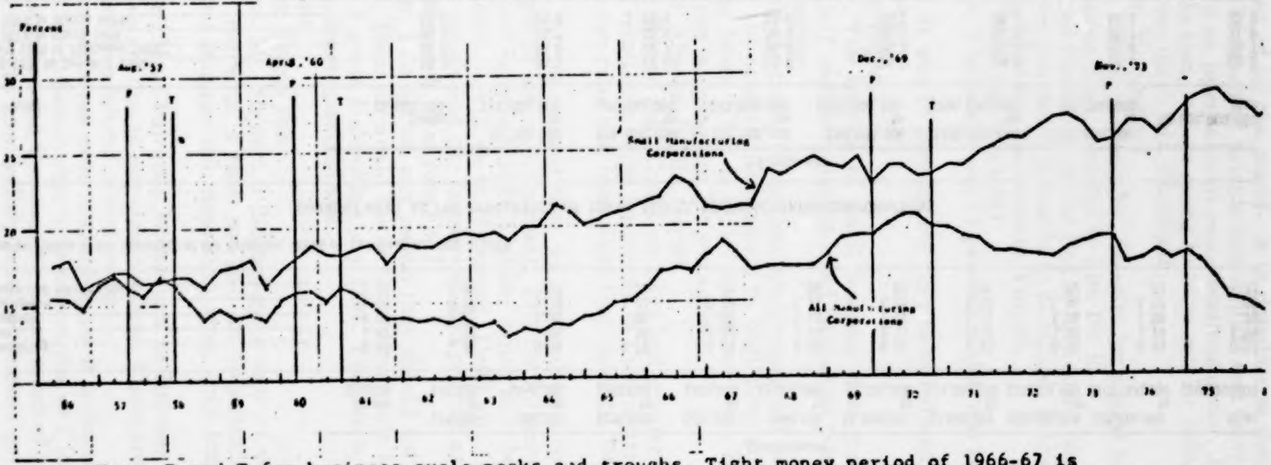
Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Oct. 4, 1979.

CURRENT DEBT AS THE PERCENTAGE OF TOTAL ASSETS, MANUFACTURING CORPORATIONS

Period	Assets size							
	Under $5,000,000	$5,000,000 to $10,000,000	$10,000,000 to $25,000,000	$25,000,000 to $50,000,000	$50,000,000 to $100,000,000	$100,000,000 to $250,000,000	$250,000,000 to $1,000,000,000	$1,000,000,000 plus
January 1975 to January 1976	34.8	31.1	29.6	27.5	24.7	24.6	22.5	20.2
February 1976 to February 1977	35.8	33.9	29.7	26.4	25.0	24,0	22.6	20.7
March 1977 to March 1978	36.6	34.7	32.0	28.3	26.0	24.3	22.7	21.9
March 1978 to March 1979	37.5	35.8	33.4	30.0	28.1	25.5	24.2	23.9

Source: FTC, Quarterly Financial Reports, various issues.

RATIOS OF INDEBTEDNESS TO BANKS AND TOTAL INDEBTEDNESS OF MANUFACTURING CORPORATIONS : SMALL VS ALL CORPORATIONS
(Third Quarter, 1956 to Third Quarter, 1976)



Note: P and T for business cycle peaks and troughs. Tight money period of 1966-67 is not indicated.
Source: American Journal of Small Businesses, Vol. 4, No. 1, July, 1979. Page 26.

TOTAL BUSINESS BANKRUPTCY FILINGS—OCTOBER 1979 TO FEBRUARY 1980

	Total businesses	Percentage change from previous month	Percentage change from October	B/NB[1]	Invol./vol.[2]
October	2,216			0.149	0.0063
November	2,334	5.32	5.32	.133	.0051
December	2,394	2.57	8.03	.143	.0046
January	2,814	17.54	26.99	.153	.0062
February	2,946	4.69	32.94	.152	.0045
March	3,284	11.47	48.19	.152	NA

[1] B/NB is the ratio of business to nonbusiness bankruptcy filings.
[2] Invol./vol. is the ratio of involuntary to voluntary bankruptcy filings.

Source: Administrative Office of the U.S. Courts.

Mr. LaFalce. It was my understanding as of our April 16 and 17 hearings that you, in connection with your task force, were going to be working over the period of 1 month and then this week come out with some type of a national strategy that perhaps would be bandaids and tourniquets. The White House Conference on Small Business did come out with a long-range strategy. I understand that long-range strategy and, for the most part, strongly concur. For the most part I also strongly concur in the recommendations you have made for long-range changes. But I am still a little hazy as to specifically what you are recommending for the short term, or what steps are being taken for the short term.

In other words, I could not walk out of here and say: Here is the strategy for small businesses who now are experiencing great difficulties.

Maybe that is my fault.

Mr. Stewart. No, no. What we are saying, Mr. Chairman, is that in the short term all we can do is help small business help itself with management advice, the community assistance, and SBA process help in the first three points.

Mr. LaFalce. What are those first three points?

Mr. Stewart. Expanding the survival defense capability of small business, and our example of the things you have to try to do: the formation of our task force——

Mr. LaFalce. So we are going to expand their survival defense capability. How are we going to do that?

Mr. Stewart. We are going to help small business manage its cash flow better.

Mr. LaFalce. How are we going to help them——

Mr. Stewart. By having small business people in each community who know how to do it counsel them, and by having publications——

Mr. LaFalce. Is there some new program that SBA will have to give special seminars or assistance? I am very much aware of the one going on in western New York, coming from western New York. But is there some national program of special seminars saying that this is a period of austerity and this is how you adjust to it?

Mr. Stewart. Yes.

Mr. LaFalce. There is?

Mr. Stewart. Yes. The Administrator gave the first signal here in this letter of October 2 in which he suggested some steps that should be taken during this period—the series of seminars, the preparation of materials such as the draft pamphlet we have displayed here, and ongoing programs indicated in appendix 3.

There is ongoing expansion of our task force to cover the entire country. All of these things are ongoing efforts.

Mr. **LaFalce**. The seminars that you are going to be having, do you have a schedule of seminars throughout the country?

Mr. **Stewart**. No; we do not now have a list of dates and places, but every district will be undertaking seminars along these lines. These are seminars being developed.

Mr. **LaFalce**. Will it take place at the district or regional level?

Mr. **Stewart**. It will take place at the district level.

Mr. **LaFalce**. When we do, will this publication, "Protecting the Small Business Cash Flow Life Line," be ready?

Mr. **Stewart**. We hope it will be available soon. The only thing that holds it up is comments on how to improve it from the members of the task force to whom it was mailed on Friday. As soon as we have that, we will then turn it out just as fast thereafter as we can. Certainly within the next 10 days or 2 weeks.

What we hope to generate across the country is, in effect, a series of self-help teams of two, three, or four people meeting in each standard metropolitan area with the existing trade associations and the existing chambers of commerce. Our regional advocates will help, our district directors will help, just to make sure that we are all doing everything we can to help as many small businesses as we can.

Mr. **LaFalce**. You said management help and community assistance help and SBA help. Is that right?

Mr. **Stewart**. When I used the word "community," I do not mean it in the sense of charity. What I mean is that every community has resources in its governments and its organized business community. Small business people help one another and are helped by banks. We are trying in an orderly way to make that work better.

Mr. **LaFalce**. You gave on page 5 the example of a financing technique that you gave a month ago. I did notice that at some point you were going out to the field for other creative-financing techniques. Have you received any information from the field as to other creative techniques that are being used?

Mr. **Stewart**. No more than are reflected in this list of 55 suggestions for cash management. That list includes, reading from page 1 of its introduction: Cash from operations, cash from external sources, Federal Government assistance programs, and the like.

Let me elaborate on this a little, Mr. Chairman. We have mentioned the Fed's making money available for seasonal loans. We have yet to hear of the first loan actually being made, the first use of the line by a bank. I cannot tell you today why that is the case.

Mr. **LaFalce**. First of all, at the time of the hearing I pointed out that this would only be of regional help. It would not help communities such as Niagara Falls, Tonawanda, or Buffalo, or what have you.

Mr. **Stewart**. Because the banks are too big.

Mr. **LaFalce**. And also, subsequent to that point in time, they were going to allow the banks that qualified to come to the window and obtain money at 13 percent. But when they eliminated the surcharge they were imposing on the larger banks, that brought it down for all to 13 percent. That was done about a week and a half or so ago.

So, I don't really know that there is a difference, but I think they just have one program now at the discount window. I could be wrong about that.

Mr. STEWART. We have not been able to find a difference, Mr. Chairman.

What we are not sure about is if this is just communication lag time, or all the banks simply waiting for the rates to go down. They just do not want to loan at 13 percent.

What we do think is necessary is for small business people to function in a more organized, orderly way than they have ever done before—and we are convinced this works. I cannot point to big changes that have resulted, but I think that small ones are brought about.

Mr. LAFALCE. I do not know that this is going to be what is needed for the small business to get through this difficult period and weather the storm.

Mr. EWING. I assume that in time the pressure on small business will ease as inflation rates and interest rates go down. So, looking ahead to the future, we should be concerned about improving the long-term prospects of small business. In the short term one naturally focuses on cash flow. However, in the longer term I am wondering if anything can be done to improve the profitability of small businesses and reduce their debt-equity ratios?

Mr. STEWART. Yes. I was one of the leaders, for example, in the fight for the job tax credit. I believe strongly that is a credit whose time will come. I think the economy may require such a credit within the next several years. I think we have to keep it on the front burner to be reviewing it.

There is a great deal of sentiment for an investment tax credit change. If that comes about, I think we have to find ways—I am talking for me alone—to graduate it by business size. We need a new system for capital cost recovery. I think we have to be sure that when we get it that its benefits are not excessively concentrated in large companies.

Each way we improve the ability of small firms to acquire and retain equity, we reduce their dependence on debt.

That is the heart of the long-term strategy. I should have made that clear.

Mr. EWING. What can the Federal Government do to more directly increase access to equity capital?

Mr. STEWART. Changes in the tax law are central. Graduate corporate income taxes—the White House Conference was correct to focus on this point, rollover in tax on capital gains from investment is small business; system of capital cost recovery, and the job tax credit. I myself would graduate corporate income taxes further than the White House Conference recommended. You cannot lower rates for small business without increasing taxes at the upper end unless we reduce our present level of Federal expenditures.

Mr. EWING. You would operate on the tax side and not on the program side?

Mr. STEWART. I would operate on the supply side, to this extent. I have great confidence in adding institutional strength to the venture capital community. I would like to see some improved versions of the SBIC which focus more on high-risk technology areas. I would like to see some incentive, apart from taxes, to improve the flow of private credit—further leverage. For example, for nationally needed research and development, I just do not believe we are going to get it given our present climate unless we provide additional leverage and more effective use of Government procurement. That is a critical way in which new small industries have been financed in this country. We don't know enough or think enough about this.

Government contracts have helped in the past. In the data processing business and the semiconductor business it helped the first generation of new small firms get a toehold in the markets. I think we need to learn how to do that more effectively.

Mr. EWING. I have one last question. You talked about improving the secondary market for SBA guaranteed paper. I suppose that would apply to other Federal business development programs as well. What specific steps do you plan to take to enhance the secondary market and, related to that, how can we bring nonbank lenders into your programs?

Mr. STEWART. I do not have any better answer to the first except that we are learning from the expansion of the market as the seasoning of the paper takes place. I do not think we know quite enough yet to come back and say that it would be better if we could do yea or nay about it.

It is only a short period of months since we have had a transfer agent to actually handle the paper. So the machinery has not yet been in place long enough to have good lessons.

On the license lender thing, I am not sure myself what a good answer is. I do not know why that program has not been more used. But I share the thrust of your question. I think we ought to find out because I do think it is helpful to have nonbank sources for the kind of long-term debt that is involved.

I do not have any good answer for you. I am much encouraged by the fact that Control Data has gone in. I think it might be useful for this committee to talk to the one experienced manager of a license lender program here in Washington who has experimented with the program. I think he has found it to be viable and is satisfied with it. I have talked with him myself. I think if we had a network of such license lenders in addition to the commercial bank structure, that it might not be a bad thing. I think it would strengthen the flow of credit and provide some competition.

Mr. EWING. Thank you.

Mr. LAFALCE. The bells are ringing, and we are going to have to bring this to a conclusion.

Did you have any press statement that you handed out in connection with this? There was no summary of what you were going to say?

Mr. STEWART. No. No, sir.

Mr. LAFALCE. I still feel as if we are still at the starting gate. I do not feel that I can go out and say that we have some type of strategy that small business can use to weather the storm. About the best I think we can say is that we have a draft of a booklet that will be released shortly.

I was hoping for more. I don't know exactly what I was hoping for—the substance of it—but I certainly was hoping for more than I have received.

So, I am disappointed. The expectation that I had, based upon the last hearing, with the enthusiasm that you expressed and the enthusiasm that the members of the task force expressed created an expectation that just has not been met.

Mr. Stewart. Well, Mr. Chairman, we are always sorry to disappoint you. We are going to continue to work on this, looking for further elements in the strategy. I think really the disappointment has to come from the fact that there is no quick-fix or easy answer for what we are into now.

Mr. LaFalce. I see.

Mr. Stewart. All we can learn is how to do better what we know we have to do.

Mr. LaFalce. I am also disappointed that we did not have existing material, if that is going to be your program, to help small businesses cope in——

Mr. Stewart. We have some.

Mr. LaFalce. We do? OK. We ought to collect them and put them in the appendix also, making it thicker.

It seems to me that there are a number of groups around the United States that do have special programs with special counseling on how to weather storms such as this. Maybe we should have the Associate Administrator from Management Assistance testifying, or call him in to testify as to what he is doing.

Mr. Stewart. Absolutely. He is working with us on all of this.

Mr. LaFalce. I looked at the agenda for the Jamestown seminar. It did not excite me all that much. Maybe that is the best we can do. I do not know. But it seems to me we can do better.

I just do not have the feeling that we have had presented here today the best that we could do in coming up with bandaids for the small business community.

I have to go now. I have about 6 minutes before a vote.

The subcommittee is adjourned.

[Whereupon at 2:02 p.m., the subcommittee adjourned to reconvene subject to call of the Chair.]

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